From:	Dee Wrona
To:	*TE/GE-EO-F990-Revision;
CC:	
Subject:	Fw: Attached please find the comments of Douglas Mancino to the redesigned Form 990
Date:	Friday, September 14, 2007 5:22:03 PM
Attachments:	pic30303.gif im55200308191235.PDF ecblank.gif

********** PRIVILEGED AND CONFIDENTIAL **********

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----- Forwarded by Dee Wrona/LAS/MWE on 09/14/2007 02:19 PM -----

Dee Wrona/LAS/MWE	ToForm 990Revision@irs.gov cc
09/14/2007 02:16 PM	SubjectAttached please find the comments of Douglas Mancino to the redesigned Form 990

********** PRIVILEGED AND CONFIDENTIAL **********

(See attached file: im55200308191235.PDF)

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September 14, 2007

Lois G. Lerner, Director
Exempt Organizations Division

Ronald J. Schultz, Senior Technical Advisor

Catherine E. Livingston, Deputy Associate
Chief Counsel (Exempt Organizations)

Internal Revenue Service
Form 990 Redesign, SE:T:EO
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Comments on Proposed Revisions to Form 990, "Return of Organization Exempt From Income Tax"

Dear Ms. Lerner, Mr. Schultz and Ms. Livingston:

The purpose of this letter is to provide you with comments on selected portions of the redesigned Form 990 and on selected portions of the redesigned and new schedules. Before doing so I have a couple of general observations.

First, this redesign project clearly has been a monumental task for which you and other members of your team responsible for it should be commended. The redesign of the Form 990 clearly is long overdue, particularly given its now almost universal access and the increasingly important need for greater transparency. While many commenters on the redesigned Form 990 have suggested delays or wholesale revisions, I do not share that view. While I do believe there is more information being sought than is reasonably necessary, even with a goal of increased compliance, in general more information is better than allowing unscrupulous organizations the current opportunity to "hide the ball" with the current Form 990. While it is fair to say that the vast majority of the nonprofit sector judiciously completes the current Form 990 and schedules accurately and completely, by soliciting greater detail from all organizations the Service will level the table. And, as you are aware, greater transparency breeds greater voluntary compliance. In fact, I am already using the draft redesigned Form 990 and schedules as a compliance tool with our clients.

Also, contrary to the views of certain commenters, I strongly support the use of more and more detailed schedules, particularly in areas relating to executive and board compensation, transactions between insiders and the organization, and specific transactions such as loans. However, I would urge the Service to consider the suggestions set forth in Part I of this letter concerning the problems smaller organizations will encounter if they are required to complete and file the redesigned Form 990 and all applicable redesigned and new schedules.

Lastly, if the Service accepts some of the recommendation in this letter as well as in the letters of other commenters and either reduces or clarifies the reporting burden, I strongly support moving forward with the required use of the redesigned Form 990 and all schedules, rather than delaying their implementation as some have suggested.

I. The Redesigned Form 990 and Its Impact on Small Organizations

Like many practitioners, I both serve on boards of smaller nonprofit organizations and advise them on a voluntary, pro bono basis. I am very concerned that, by requiring all organizations other than those exempt by statute to file the full Form 990 and all applicable schedules, small organizations will be adversely affected in several ways.

First, small organizations are already affected financially by the requirement in many states of having their financial statements audited by independent accountants. In California, the threshold is $2 million in gross revenues, whereas in states such as Pennsylvania and Illinois the threshold is even lower, if the charitable organization desires to register to solicit funds. Small charitable organizations find it difficult enough to locate independent accountants who are not only knowledgeable about the accounting for nonprofit organizations but also are available and affordable. For example, in Southern California, the approximate cost of having an independent accountant audit the financial statements of a small nonprofit organization with revenues in the $1 million to $2 million range is anywhere from $15, 000 to $25,000. If the full burden of filing the redesigned Form 990 and all applicable schedules is placed on small nonprofit organizations, without modification, small nonprofit organizations will incur substantial additional costs not only for the new systems that will be required to support their ability to complete the form and applicable schedules, but also for the outside professional help they will need to do so. It is not uncommon in smaller nonprofit organizations for a volunteer treasurer to complete the federal and state information returns. I can assure you it will be virtually impossible for a volunteer with only limited experience in the exempt organization field to do so with the new Form 990 and new and revised schedules. While we have received quotes for return preparation from small accounting firms to prepare the Form 990 for smaller organizations in the range of $3,500 to $5,500, I can virtually assure you that the cost for this compliance will increase particularly with the breadth of the expanded return preparer penalties. The unintended consequences of requiring small organizations to file the redesigned Form 990 and all applicable schedules can be illustrated with a charity on whose board I serve.

I chair the Board of Trustees of an organization that provides medical care to children who have suffered burns. The organizations also provides prevention education and other services. It raises approximately $1.2 million a year from a large special event, from foundation grants, and from contributions from the genera public. In addition, it recently received a large grant from FEMA. I estimate that its costs of obtaining audited financial statements (which it does, voluntarily) and information return preparation, including all applicable schedules, will total between $40,000 and $50,000 if it is required to file the redesigned Form 990 and all applicable schedules. All of these increased expenses will be administrative costs. The increase in costs for compliance by filing the full redesigned Form 990 and all applicable schedules will increase its administrative costs by an estimated 1.5%. This may not seem like much of an increase in the abstract, but when potential funders such as private foundations look at expense ratios on the first page of the redesigned Form 990 it will potentially damage the organization and negatively impact its fundraising ability.

In addition, there are many questions on the redesigned Form 990 that will create negative inferences with the public and potential funders if the questions are answered "no." For example, Part III, Line 9, asks whether the organization has an audit committee. In California, the first state to enact an audit committee requirement for charitable corporations, the threshold for having an audit committee is $2 million in gross revenues. Also, the requirement only applies to charitable corporations and not to charitable trusts or unincorporated associations. Consequently, many small nonprofit organizations do not have a separate audit committee because they are not required to and they probably already have too many committees as it is. Requiring a small organization to answer this question "no" creates the impression that the organization does not employ best practices and may not have adequate internal controls. Similarly, Part III, Line 4, asks whether the organization has a whistleblower policy, and Line 5 asks whether the organization has a written document retention and destruction policy. Small organizations have no need for a written whistleblower policy because there are few layers between the small number of staff they might employ (two or three) and board leadership. Similarly, the only type of document retention and destruction policy they need is a basic common sense one designed around compliance with IRS record retention requirements and state fiduciary duty considerations. Yet, by asking small organizations to answer "no" will again create negative inferences with the general public and potential funders.

Many small nonprofit organizations benefit from having experienced exempt organization practitioners such as myself serve on their boards and, as with the small organization, I chair described above, they have been able to institute or adopt most if not all of the policies or practices identified on the redesigned Form 990 without additional cost. However, not all small organizations are so fortunate and those organizations will be forced to make a difficult choice, take the risk that public perception will not be adversely impacted by answering "no" to many essentially irrelevant questions, or incur outside legal and consulting expense to the detriment of program services in order to put those policies and practices in place.

I do not believe the current Form 990-EZ is the solution, in part because it does not elicit enough information and in any case the threshold for filing it is too low. Instead, I have two recommendations.

1. Pare down the redesigned Form 990 and pare down the number of schedules specifically for small organizations, that is organizations with gross revenues of $2 million or less. Keep the schedules that are most important, and most necessary for compliance, such as the schedules for executive compensation and loans to insiders. However, reduce the questions that common sense would suggest are irrelevant or too costly to implement by, small organizations.

2. Increase the dollar threshold for filing several of the schedules. For example, Part IV, Line 11a requires an organization to attach new Schedule G if the gross income from fundraising events, exclusive of their contribution portion, exceeds $10,000. This threshold should be increased for all organizations, not just small organizations, but its impact will be most felt by small organizations. I recommend increasing the filing threshold to $100,000 or $250,000, unless the fundraising event involves gaming.

II. General Comments to the Redesigned Form 990

Part I, Summary

I believe that the summary page creates a very useful "dashboard" for the public, for funders, and for professionals such as myself who obtain 990s from GuideStar on an almost daily basis. I agree with some of the commenters who have questioned the appropriateness of the ratio analysis, such as Line 19b, and Line 26, I think the benefits of disclosure outweigh the negative implications. There undoubtedly will be instances where the ratios may be misleading. This is particularly true in multicorporate systems of exempt organizations with centralized management functions, where officer and key employee compensation will constitute most of the organization's program service expense and Line 8b will be exceedingly high. In those cases, it will be incumbent upon the organizations to attach schedules to explain these matters but, conversely, there must be sufficient capacity to add narrative information on forms that are filed electronically. In addition, perhaps a check box could be added to these questions to signal that additional information is attached.

Part II, Compensation Arrangements

Section A: This will be the first page that most funders and reporters will be interested in and I think the increasing of the threshold to $100,000 coupled with the eliciting of more detailed information is very helpful.

Section B: Line 5. The inquiry concerning whether "any person who is or was an officer, director, trustee, or key employee within the past 5 years" has one or more relationships with persons on Schedule A will be virtually impossible for most organizations to answer without extreme effort. Directors and officers turn over frequently – particularly directors, who may number in the dozens. This question would require an organization to keep in touch with all persons who were directors or officers within the past 5 years so that those persons could be queried as to their relationship with persons listed on Schedule A. If former directors and officers are to be included, they should be limited to those who are currently being compensated by the organization. In other words, question 5 should be reworded to ask whether during the tax year any person who is listed in Section A has any of the relationships listed in 5 a-c.

Section B: Line 5e. I think this question is overly broad. For example, if an attorney serves on the board of an organization and is a partner in a large law firm, with several hundred partners, his or her percentage ownership will likely be very low, and compensation of $5,000 in fees would be an incredibly low threshold for any concern. I think the threshold should be increased to a more meaningful amount, such as $100,000. This is particularly necessary due to the fact that there is a five year look-back period. Similarly, there ought to be excluded routine banking or similar transactions such as brokerage transactions where fees are typically set by the institution, not the individual, and would be the type of transaction exempt from the application of the self dealing rules applicable to private foundations.

Part III, Governance, Management and Financial Reporting

The Instructions require all organizations to answer each question even though certain policies and procedures may not be required under the Internal Revenue Code. As I indicated at the outset, I am troubled about the negative inferences "no" answers will elicit. For example, for certain types of organizations there is no requirement to have an independent member on the governing body, such as medical research organizations. In others, while it may be helpful in determining the organization's public charity status, it is nonetheless not a requirement.

Line 1 asks for information concerning the governing body and the instructions provide no guidance as to what that term actually means. For example, a large health system comprised of multiple hospitals may operate through a single nonprofit corporation. Each hospital or operating unit may have a local body that serves in an advisory capacity to the board of directors of the nonprofit corporation and that serves as the "governing body" for licensure and accreditation purposes. For example, the local "governing body" may approve medical staff appointments, but it may not have any actual budgetary approval. At a minimum, the instructions should make it clear that the term "governing body" for purposes of the redesigned Form 990 is limited to a governing body that has fiduciary responsibilities with respect to the organization. Similarly, an organization may have emeritus or honorary directors or trustees.

Again, these persons should not be considered part of the governing body. Such a position would be consistent with state law fiduciary duty concepts. See, e.g., *Steeneck v. University of Bridgeport*, 668 A.2d 688 (Conn. 1995).

Line 1 also asks for the number of members of the governing body and the number of independent members of the governing body. The instructions indicate that members should be included regardless of whether they have voting privileges. The instructions should be revised to exclude nonvoting members. Including nonvoting members provides a misleading indicator of the number of actual decisionmakers in the organization's governance. For example, many organizations may have honorary or life trustees who are entitled to attend meetings as recognition of their long service but who are not entitled to vote. Further, including nonvoting members permits manipulation of the proportion of members who are independent. Voting members might be primarily interested parties while the organization could have a large number of independent members who are nonvoting.

Line 2 requires the organization to report significant changes to its organizing or governing documents. However, the instructions require that the organization must report, literally, any change in a number of items that frankly are routine and occur in most organizations with some frequency. For example, it is not uncommon for the number of board members to change, sometimes requiring an amendment to the bylaws. Furthermore, changes in policies occur within organizations all the time and in all types of organizations. The instructions should impose a materiality standard. Despite this criticism, however, asking for changes to the governing documents, rather than the amended documents themselves, is a big improvement.

Line 3b asks how many conflict of interest transactions were reviewed. This raises several problematic issues. First, it is unclear how to measure how many transactions were in fact reviewed. Second, it is unclear by whom these transactions would have been reviewed, and tracking the number would be difficult and burdensome. Most importantly, it is unclear whether a favorable answer would be the review of many transactions (which could indicate many problems or a high rate of diligent oversight) or the review of few transactions (which could indicate few problems or a low rate of diligent oversight). Instead of numbers, what should be of greatest concern to the Service on the Form 990 is that an organization has a conflict of interest policy and set of procedures and disclosure forms that provide a diligent and effective means of identifying, assessing and managing potential conflicts. Therefore, we suggest that Line 3b be revised to ask questions about the organization's policy and process instead of asking about the number of transactions that have been reviewed.

Line 10 asks whether the organization's governing body has reviewed the Form 990 before it was filed. Again, the definition of governing body is critical here because non-fiduciary advisory, emeritus or honorary trustees should not be included. In addition, the instructions should clarify that the governing body is not required to actually approve the return before it is filed.

Part IV, Statement of Revenue

Line 1 describes contributions, gifts, grants and other similar amounts. Line 1g requires disclosure of non-cash contributions and if the amount exceeds $5,000 the instructions indicate the organization must complete and attach Schedule M. I recommend that the instructions be clarified in two respects to reduce recordkeeping burdens. First, if the organization only receives non-cash contributions in the form of publicly traded securities, the threshold should be increased to a number such as $100,000. Second, if the organization is required to file a Schedule M, the instructions to Schedule M should clarify that for purposes of completing the Form 990 and Schedule M non-capital items such as contributions of food inventory, drugs and medical supplies should be reported at their fair market value even if the contributor is not entitled to a charitable contribution deduction for the fair market value of such property.

Line 2c refers to revenue from related investments and the instructions clarify that that refers to program-related investments. I suggest inserting the word "program" before "related" on the form itself to reduce confusion.

Line 11a deals with gross income from fundraising events. As suggested earlier, the threshold for filing Schedule G should be increased from $10,000 to some larger number.

Part V, Statement of Functional Expenses

Line 1 asks for the amount of grants to governments and organizations in the U.S. The $5,000 threshold for filing Schedule I seems low, and should be increased to $100,000 similar to the threshold for reporting compensation payable to past and former officers and directors. Similarly, on Schedule I itself, there should be some standard of materiality. For example, if a nonprofit organization participates in its local United Way campaign, and matches the contributions of its employees, it may make grants well in excess of $5,000 in their entirety but the grants may be comprised of amounts in the $50, $100, to $250 range. Similarly, the instructions to Schedule I ought to exclude contributions made by the organization pursuant to a bonafide matching gift program.

Part VI, Balance Sheet

Line 11 asks for "other securities" as listed in Part 1 of Schedule D. The Schedule D instructions indicate that every non-publicly traded investment, including securities, partnerships and funds, should be listed. Large organizations with diversified and alternative investments may list hundreds or thousands of discrete investments on this schedule. The resulting list will be a mountain of detail with no real information. This has proven to be the case with private foundations that simply append pages and pages of brokerage statements to their Forms 990-PF.

If the Service wishes to see more details on types of investments than on the current 990, the form or instructions should provide categories of investments into which numbers would be aggregated, instead of asking for every investment.

Part VII, Statements Regarding General Activities

Line 10 asks if the organization has a written policy or procedure to review the organization's investments or its participation in disregarded entities, joint ventures or other affiliated organizations. Most small organizations will answer this question "no" because they may have little or no investments and it is highly unlikely they would be participating in joint ventures and similar arrangements. This again is one of those examples of a negative response creating a negative inference for the person reviewing the Form 990. At a minimum, the negative inference will be that the organization is not responsible because it does not have one or both policies, and the second negative inference may be that if the organization doesn't have a policy with regard to joint ventures, for example, that it does so in disregard of its fiduciary duties.

Line 12 asks whether the organization has a written policy that requires the organization to safeguard its exempt status with respect to transactions and arrangements with related organizations. Quite frankly, this is a "When did you quit beating your wife" question that creates potential for serious negative inferences in otherwise benign circumstances. At a minimum, I would limit this to transactions with related, nonexempt organizations, and include an N/A column if possible.

Lastly, Line 16 asks about term or permanent endowments. If the organization has endowments, the organization is required to complete Schedule D. I recommend the Service consider adding a materiality threshold so that small organizations or organizations with small endowments are not put through the need to complete a complex schedule to an already highly complex Form 990.

Part VIII, Statements

No comments.

Part IX, Statement of Program Service Accomplishments

This is probably the most important page for organizations, particularly charitable organizations, because it gives them the opportunity to tell their stories. Placing it at the end of the Form 990, rather than on Page 2, seems to deemphasize program service accomplishments that serve as the basis for the organization's exemption and instead emphasize potentially "hot button" issues such as executive and board compensation, governance practices, and the like. In fairness to organizations that file the revised Form 990 there should be greater emphasis on program service accomplishments. Also, with returns that are required to be filed electronically, there will need

to be sufficient additional space available so that organizations can include more detailed information, such as that found in a management's discussion and analysis section of an offering circular.

III. Comments on Schedules

As I indicated at the outset, I very much favor the use of detailed schedules. The need for more detailed schedules could not have been more apparent then at the Senate Finance Committee hearings a few years ago. During many of those hearings, particularly those critical of the nonprofit sector, many of the charges were based on anecdotal evidence rather than fact-based evidence that created the impression, for example, that loans between charitable organizations and members of their boards of directors or officers were extraordinarily prevalent when, in fact, the laws of many states prohibit or limit the making of loans between a nonprofit corporation and its directors or officers.

In addition, I strongly support the extensive use of schedules for the reasons discussed by the Service in the teleconference.

Also, as indicated at the outset, I recommend the Service strongly consider increasing thresholds for having to file certain schedules, many of which were discussed and recommended in the preceding sections.

Schedule A. I commend the Service on its reformatting of Schedule A. Schedule A now provides clarity for determining the specific type of public charity and the separation of the support schedules for section 170(b)(1)(A)(iv) and (vi) organizations and section 509(a)(2) organizations will reduce confusion.

Schedule B: Schedule of Contributors. The Service may wish, at some time, to create a Schedule B-1 and a Schedule B-2, one for organizations filing Form 990 or Form 990-EZ, and one for Form 990-PF filers. This will allow clarity as to which type of organization is required to make the unredacted Schedule B available for inspection by the general public.

Schedule D: Supplemental Financial Statements. This is a schedule that should only be applicable to large organizations and organizations that may engage in potentially problematic activities, such as by receiving conservation easements, maintaining donor advised funds, or maintaining collections of art and similar assets.

Schedule G: Supplemental Information Regarding Fundraising Activities. As discussed above, the threshold for filing this schedule should be increased from $10,000 to $100,000, except in the case of gaming activities.

Schedule H: Hospitals. Schedule H applies to hospitals, and the draft instructions include a definition of hospitals. The instructions fail to note, however, that the definition of hospitals in section 170(b)(1)(A)(iii) also includes clinics. Also, the Schedule H instructions should clarify that the Schedule H is not applicable to medical research organizations also described in section 170(b)(1)(A)(iii).

Part I includes the community benefit report. In my view, the use of the term "charity care" for this purpose is unhelpful. Rather, I suggest that the term "free, unreimbursed or below cost care" be used instead. Also, I am not sure whether the Service should weigh into the charity care debate by excluding unreimbursed Medicare revenues from a specific line item, because that creates the appearance, at least, that unreimbursed Medicare costs are not as important as unreimbursed Medicaid costs.

Also, by giving hospitals the option to calculate the cost of charity care based on either the Medicare cost-to-charge ratio or an internal accounting system, comparisons between hospitals may become difficult if not impossible, and could also allow hospitals to change the approach from year-to-year thereby preventing meaningful year-over-year comparisons.

Charitable contributions used to support charity care should not be used to reduce net charity care. This seems counterintuitive because one of the factors evidencing that an organization is charitable is the nature and amount of contributions it receives. Another concern is the exclusion of bad debts. As the Service is well aware, it is often difficult for a hospital to make a determination whether an individual is an appropriate recipient of charity care until sometime during the billing and collection process. At a minimum, bad debts that are later determined to be charity should be included in Part I, under the heading Charity Care, and that information should not be relegated only to the Page 2 discussion of billing and collection practices.

Various questions in Parts I, II, and IV ask open-ended questions about charity care policies, collection practices, and the like. Making these more guided and specific questions – for example, asking about the items mentioned in the instructions – would both be easier for the organization to complete and would provide more standardized and comparable information to the Service.

Part II, Section A asks for billing information. Most organizations will find this section impossible to complete in its present form. This section would be more useful if the approach were to reconcile and provide more detail as to the contractual allowances and similar information provided in the financial statements (e.g., show gross Medicare charges, Medicare contractual allowances booked, and accrued Medicare revenue). In addition, the "fees collected" amount (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 – should be used, even though it may not correspond to services provided during the reporting period. Finally, we suggest making completion of this part of the Schedule H optional for a short transition period so that meaningful data can be accumulated.

Part V asks for facility information. There should be some level of materiality here so that it is not necessary to report concerning small facilities. For example, if an organization has five or more facilities, it should be permitted to exclude from listing facilities that generate gross revenues of less than $2 million or another appropriate amount.

Schedule J elicits information concerning compensation. First, I recommend the Service eliminate Line 1(D) for nontaxable benefits or clarify that such nontaxable benefits do not include those provided under a plan that does not discriminate in favor of highly compensated employees or one whose benefits are excluded under section 132 of the Code. Second, Question 3 on this schedule, which asks whether the organization paid or reimbursed for first-class travel, club dues, or use of personal residence, is another "When did you quit beating your wife" question. Instead, this question could ask whether the organization's written policy regarding payment or reimbursement of travel and entertainment expenses (referenced in question 2) provides for reimbursement of these types of expenses.

Schedule K requests supplemental information on tax exempt bonds. Parts I, II and IV seem fairly straightforward with the exception of Part I, Column G, which asks for the date the project funded by the bond issue was placed in service. In most cases, a number of different assets/projects are funded by a single bond issue and clarity should be provided in the instructions concerning the meaning of "placed in service" in accordance with the regulations.

Part III appears to be fairly awkward and open to wide interpretation. The questions are somewhat confusing and might generate responses that are not intended or relevant.

Schedule L elicits information concerning loans. I think this is a welcome addition and will be of great use in determining compliance levels as well as whether there is actually a problem with insider loans that needs a legislative solution.

* * *

I close this letter by again commending you and the other members of the team that were involved in this monumental project. Transparency will clearly be increased and voluntary compliance levels will as well.

Sincerely,

Douglas M. Mancino

DMM/dw

From:	Temkin, Susan
To:	*TE/GE-EO-F990-Revision;
CC:	
Subject:	WASHINGTON-#4910372-v1-Comments_on_Redesigned_Form_990.DOC
Date:	Friday, September 14, 2007 7:56:53 PM
Attachments:	WASHINGTON-#4910372-v1-Comments_on_Redesigned_Form_990.DOC

Lois Lerner
Internal Revenue Service
By email to:

Re: Comments on IRS Redesigned Form 990

We submit the following comments in response to the redesigned **IRS Form 990, Return of Organization Exempt From Income Tax Under Section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation).**

SUMMARY

The charitable sector provides precious resources for education, health, medical research and the like. Although estimates vary, experts project that trillions of dollars in wealth will be transferred to the charitable sector in the next twenty years. We are very concerned that the nature and degree of private information about individuals and for-profit entities required by the redesigned Form 990 would operate as a serious deterrent to their involvement in the charitable sector, because such information would be made available worldwide over the Internet and from other publicly available sources. It means that wealthy potential donors who would choose to be active in the organizations they support, or skilled professionals who would be interested in working for such organizations, would have to be willing to accept personal exposure. This is incredibly short-sighted. Requiring the reporting of information about personal income from sources other than the charity on a publicly disclosed return permits this information to be viewed by neighbors, colleagues, the press, other members of the public and, even worse, identity thieves. Doing so would be a deterrent to serving as an officer or director of a charity. People who value their personal privacy and security will have to think long and hard about the protections they will lose if they work for a charity, or even if they choose to volunteer their time. Furthermore, we are unable to understand the benefit of making such information publicly available, because such information by itself is insufficient to indicate whether a charity has engaged in an improper activity, such as an excess benefit transaction or private inurement. Finally, the objective of providing the IRS with the information necessary to police the rules governing charities can be fully achieved by requiring information to be submitted on forms, such as Forms 1040, 1120, etc., that are not subject to public disclosure. Thus, this disclosure should be eliminated.

Public Disclosure of Compensation from Related Organizations Will Not Enhance Public Accountability

Historically speaking, disclosure provisions applicable to the annual returns of exempt organizations were put in place to enhance oversight and public accountability of exempt organizations. Therefore, information such as the compensation paid to officers, directors, and certain employees by an exempt organization is reportable on the organization's annual return, which is subject to

public inspection. Thus, public inspection of this return information is intended to lead to enhanced oversight and public accountability with respect to compensation practices.

At the same time, it has long been recognized that there are important privacy issues in connection with the affairs of private individuals and for-profit entities. Information regarding personal income, including the taxpayer's identity, the nature, source, or amount of his income, his net worth, and his tax liability, is generally reported on IRS Form 1040, U.S. Individual Income Return and is generally not subject to public disclosure, unless such disclosure is specifically permitted by law. The types of disclosure of such information permitted under law include disclosure to persons designated by the taxpayer, disclosure to state tax officials and law enforcement agencies, and disclosure to federal government officials. Even where disclosure is permitted by law, it is often limited such that only the information absolutely necessary for the purposes for which the disclosure is made is permitted to be viewed. Both criminal and civil penalties may apply if the IRS discloses such information, except when the disclosure is specifically permitted by law.

These prohibitions against disclosure recognize that the taxpayer's privacy with respect to such information is paramount and should only be divulged to achieve a compelling purpose. Disclosing such information to the public exposes the taxpayer to harm such as identity theft; the Federal Trade Commission estimates that 9 million Americans per year are the victims of identity theft, wherein personally identifying information about an individual is used to commit fraud or other crimes. The redesigned Form 990 requires an exempt organization to report the names, cities and states of residence, and compensation of individuals who serve as officer, directors, and trustees of, or are paid in excess of a certain amount by, the exempt organization. This would make any individual serving in such capacity extremely susceptible to opportunistic identity thieves who need only run an Internet search to cull such information from publicly available exempt organization annual returns.

Presumably, the purpose of requiring exempt organizations to report compensation paid to their managers and highly compensated individuals from related organizations is to determine whether the organization has indirectly engaged in prohibited private inurement or excess benefit transactions. However, the determination of whether private inurement or an excess benefit transaction has occurred is made on the basis of measuring the value and quality of the services provided by the individual against the compensation paid to him or her. The redesigned Form 990 requires the organization to list not only the compensation received by each manager and highly compensated individual, but also that individual's title and whether the individual is employed full or part time in such capacity. The public cannot draw any reasonable conclusions about the compensation without an in-depth knowledge of the individuals' qualifications, the scope of services being performed, proper data on comparable services in comparable organizations in the same geographic location and other organizational factors that influence this process. Similarly, the public has no basis to determine the reasonableness of compensation as compared to the services provided by the same individual to a related for-profit organization or to undertake a meaningful analysis of the split between the two organizations. We also note that an individual who works for a for-profit organization and volunteers his or her time to the related charity will be subject to the disclosure of private information despite the fact that there is no possible overpayment of compensation.

While it may be in the public's interest to know whether an organization has engaged in an excess benefit transaction or private inurement, such information is already otherwise available on Form 990. Organizations must report whether they have engaged in excess benefit transactions during the year, or whether they became aware of such transactions from prior years, and complete a schedule

which includes the name of the disqualified person, a description of the transaction, and whether the transaction was corrected. Even if an organization fails to properly report, an inquiry will need to be made in order to evaluate whether an excess benefit transaction has occurred. Such a determination will require more information than is currently found on the redesigned Form 990 and must be handled by compensation experts and those knowledgeable about the Internal Revenue laws that apply to these transactions. Thus, publicly disclosing for-profit compensation, in order to compare it against compensation paid by the exempt organization, serves little, if any, purpose.

We also note that the IRS currently collects this compensation information paid by for-profits and has the power to obtain this information and enforce compliance with the Internal Revenue laws without violating privacy rights. We support changes in reporting that enhance compliance and promote transparency for the exempt organization, but believe that the IRS has gone too far when it fails to protect the privacy of information of individuals and businesses in the private sector. Thus, there is no justification for the IRS to compromise the privacy rights of individuals and for-profit entities when it is not needed to enforce compliance with the Internal Revenue laws and the information can be obtained in readily digestible form as outlined below.

Public Disclosure of Compensation from Related Organizations May Result in Harm to Related Organizations, Individuals, and Exempt Organizations

The disclosure that would be required by redesigned Form 990 would be harmful to related for-profit organizations, which could be subjected to a competitive disadvantage with respect to other for-profit organizations that are not required to publicly disclose compensation paid to executives and employees. Furthermore, those executives and employees could be personally harmed by the disclosure for the same reasons stated above. Yet, there seems little or no oversight benefit to the disclosure as regards the related for-profit organizations, inasmuch as the public cannot determine whether compensation paid by a related for-profit organization to an individual for his or her services to that organization is reasonable. The fact that for-profit entities become vulnerable to losing their employees to competitors and that the individuals lose their privacy must be weighed against the meager benefits of this disclosure.

Moreover, there does not appear to be any legal mechanism through which an exempt organization can compel private individuals and for-profit corporations to disclose to the exempt organization private information such as compensation received from sources other than the exempt organization, and the revenues and assets of for-profit corporations. Thus, the exempt organization may be unable to disclose such information on its annual return, which could result in the imposition of penalties.

Disclosure of Income and Assets of a Related Corporation Serves No Purpose

A relationship can exist between a for-profit and a non-profit if individuals that are directors, officers and employees of the for-profit are directors and trustees of the non-profit. In this case, the redesigned Form 990 requires the income and assets of the for-profit to be reported on Schedule R. It is unclear what, if any, purpose this could serve. In fact, even if all the exempt organization's directors and officers serve as volunteers, thus creating no reportable contractual relationships, the related for-profit organization's information, including total income and assets, would still be reportable on the redesigned Form 990. There must be a clear nexus between the information sought and the compliance objective that the IRS seeks to enforce. Even if there was a contractual

arrangement, it would make sense to report this arrangement rather than the for-profit's assets and income. We cannot identify any purpose that this might serve. It also should be eliminated.

Faced with a breach of privacy and possible resulting harm to both the individual and the employer, an otherwise qualified individual may choose not to participate in the activities of an exempt organization. The charitable sector needs the expertise of highly talented individuals to assist them in planning and implementation of their charitable goals.

Purpose of Reporting Compensation from Related Organizations May Be Achieved without Public Disclosure

We suggest that for-profit compensation paid to individuals may be obtained by requiring individuals who receive compensation from an exempt organization to report compensation from related organizations on a newly created, separate schedule attached to IRS Form 1040, *U.S. Individual Income Return*. Because information submitted on Form 1040 is confidential, except in certain circumstances, this information will not be subject to public disclosure. This schedule may be forwarded directly to the Tax Exempt and Government Entities Division to expedite review and to enhance enforcement. The Service would have access to all information concerning the services provided to each organization, the hours spent and the compensation paid by each organization. Thus, this arrangement will shield taxpayers and related organizations from the harm that may occur as a result of public disclosure. Individuals that have engaged in no wrongdoing, whatsoever, will maintain their privacy. Any individual or organization that has engaged in an excess benefit transaction will have to report it on the Form 990.

We respectfully suggest, for the reasons described above, that all information regarding the specific amounts of compensation paid to managers and highly compensated individuals from related taxable organizations and such individuals' cities and states of residence not be reported on Form 990, which is subject to public disclosure requirements. Compensation from related organizations could be reported on a newly created schedule to the Form 1040, allowing the IRS quick access to the information and giving the IRS the ability to make further inquires in appropriate situations. At the same time, those willing to serve in the charitable sector will not have to worry that their personal information might be posted on the Internet. There must be a balance between informing the public and protecting the rights of individuals and their private information. Although the IRS and many other groups who wish to monitor charities may use the information for proper purposes, others can use the information to target individuals for identity theft and for unwanted marketing contacts, etc. We also believe that the income and assets of related for-profit corporations should be deleted so that corporations won't become susceptible to headhunters and competitors.

September 14, 2007

Respectfully submitted,

Susan O. Temkin
Melissa C. Tai

Patton Boggs LLP
2550 M Street, NW
Washington, DC 20037

From:	Eric K. Gorovitz
To:	*TE/GE-EO-F990-Revision; Lerner Lois G; Schultz Ronald J; Livingston Catherine E;
CC:	
Subject:	Comments on Proposed Redesign of Form 990, and Schedule C
Date:	Friday, September 14, 2007 8:04:14 PM
Attachments:	Letter to IRS re Form 990 and Schedule (00063171).PDF

Dear Ms. Lerner, Mr. Schultz, Ms. Livingston and Ms. Pattara:

Attached please find our comments on the proposed redesign of Form 990 and Schedule C.

If you have any questions or concerns, please contact me at the number below.

Best,

Eric Gorovitz

<<Letter to IRS re Form 990 and Schedule (00063171).PDF>>

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September 14, 2007

VIA E-MAIL

Ms. Lois G. Lerner
Director, Exempt Organizations Division, Internal Revenue Service

Mr. Ronald J. Schultz
Senior Technical Advisor to the Commissioner of TE/GE

Ms. Catherine E. Livingston
Deputy Associate Chief Counsel (Exempt Organizations)

Ms. Theresa Pattara
Project Manager, Form 990 Redesign, SE:T:EO

Internal Revenue Service
Form 990 Redesign, SE:T:EO
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: **Comments on Proposed Redesign of Form 990, and Schedule C**

Dear Ms. Lerner, Mr. Schultz, Ms. Livingston, and Ms. Pattara:

We appreciate the opportunity to submit comments on the draft redesigned Form 990, on behalf of the following clients: Humane Farming Association, a section 501(c)(3) organization; Olson, Hagel & Fishburn, LLP, a law firm whose practice focuses on California and federal election laws; Planned Parenthood Affiliates of California, a section 501(c)(4) organization with affiliates exempt under both section 501(c)(4) and 501(c)(3); PowerPAC.org, a section 501(c)(4) organization; Service Employees International Union Local 1000, a section 501(c)(5) organization; and Washington Education Association, a section 501(c)(5) organization.

We are keenly aware of the complexity of redesigning Form 990. We agree with other commentators that accomplishing that task properly will take time, and we believe that the Service should not rush to complete the redesign too quickly. We would prefer to see a carefully planned reporting system that closely tracks current law while providing

flexibility to accommodate future changes, rather than to see a revised form released too soon, with significant legal or conceptual flaws.

These comments focus on the impact of the proposed draft on reporting of lobbying and political activities by non-section 501(c)(3) organizations. Consequently, these comments are directed primarily to Part VIII, lines 1 and 2 of the draft core Form 990, and the draft Schedule C. Others at our firm are submitting comments on the proposed Form 990, Schedule A. We have not undertaken to identify or discuss typographical errors, nor to identify every circumstance in which changes we propose will require conforming changes to instructions, headings, etc. We expect that the Service will take careful steps to address those issues at an appropriate time.

I. Introduction and General Principles

We agree with the Service that "the current Form 990 has not kept pace with changes in the [tax-exempt] sector and the law," and we submit these comments to promote the three "guiding principles" that the Service identifies as underlying the entire redesign project: enhancing transparency, promoting compliance and minimizing the burden on filing organizations.[1]

Keeping those principles prominently in mind, the revisions we propose seek to ensure that the forms achieve three goals. First, the forms should provide the public generally with reliable, comparable, and comprehensive information about what an organization does and how it is funded. Second, the forms should address the filing organization's compliance with any limitations on lobbying and political campaign activity that apply to the organization as a consequence of its exempt status, and provide an objective basis for the Service to evaluate the organization's tax liability. The third goal is a corollary of the other two: the forms should not require an organization to report in detail on activities that have no impact on its tax-exempt status or tax liability, or to respond to questions that do not provide reliable, useful information to the public about the organization's funding or operations. Each of our comments is intended to maximize the accomplishment of one or more of these goals.

Undergirding most of our comments are three substantive problems we see with the current draft. The first involves the lack of clarity of the term "political campaign activity" as used in the draft forms, instructions, and Glossary. The second involves a tendency toward overbreadth in the tracking and reporting requirements for some organizations that engage in lobbying. The third involves the prospect that the design of the new form could result, inappropriately, in *de facto* changes in policy that have not been subjected to sufficient scrutiny. Below, we first describe these primary concerns. In

[1] Internal Revenue Service, "*Background Paper: Redesigned Draft Form 990*," at 2, accessed on August 30, 2007 at http://www.irs.gov/charities/article/0,,id=171216,00.html.

Section II, we make specific line-by-line recommendations to address these and other, more detailed concerns. Section III provides a summary of our key recommendations.

Principle 1: The basic definition of "political campaign activity" on Form 990 should be the definition of political campaign activities that are prohibited for section 501(c)(3) organizations. [2]

The Service has provided relatively robust (though not comprehensive) guidance about the contours of the definition of political campaign activity for section 501(c)(3) organizations through regulation,[3] revenue rulings,[4] private letter rulings,[5] and internal training materials.[6] Although some important details remain unclear, most section 501(c)(3) organizations can look to this existing guidance to make fairly consistent determinations about which activities fall within the definition. In addition, the same definition is used by other section 501(c) organizations to demonstrate compliance with the "primary activity" requirement that applies to their tax-exempt status.[7]

Starting from a single, relatively clear definition will enhance transparency and promote compliance by providing a reporting framework that is compatible with the practice and understanding of the full range of relevant organizations. For purposes of Form 990, we believe that the section 501(c) definition of political campaign activity is the appropriate tool for determining which section 501(c) organizations should be directed to complete Schedule C.

We recognize that this definition of political campaign activity differs significantly from the definition of "exempt function activity" that applies to section 527 organizations.

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[2] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code").
[3] Reg. § 1.501(c)(3)-1(c)(3)(iii) (defining "action" organization).
[4] *See, e.g.*, Rev. Ruls. 67-71 (campaigning on behalf of school board candidates prohibited); 72-512 (university course may require student participation in political campaigns); 72-513 (campus newspaper may publish student editorial views on candidates); 74-574 (501(c)(3) broadcasting station may provide free airtime to *bona fide*, legally qualified candidates); 76-456 (candidate pledges not permitted); 78-248 (examples of permissible and impermissible voter education activities); 80-282 (publication of voting records permissible under certain conditions); 86-95 (public forums involving qualified congressional candidates permissible under certain conditions); 2004-6 (distinguishing public policy advocacy from electioneering for 501(c)(4), (c)(5) and (c)(6) organizations); and 2007-41 (analyzing whether each of 21 situations constitutes prohibited political campaign intervention by a section 501(c)(3) organization).
[5] *See, e.g.*, PLRs 8936002 (ad campaign coinciding with presidential debates did not constitute intervention in a political campaign); 9117001 (partisan voter registration activities and public communications prohibited); 9609007 (certain fundraising letters are political campaign interventions); 9635003 (report rating candidates prohibited); 200602042 (certain fundraising letters are not political campaign interventions). We recognize that private letter rulings, internal training materials and other informal statements are not precedential guidance, but exempt organizations and their counsel do look to these materials to help them evaluate how the IRS may apply the law to specific facts and circumstances.
[6] *See, e.g.*, "Election Year Issues," Exempt Organizations Continuing Professional Education Technical Instruction Program for FY 2002.
[7] PLR 9808037 (citing Rev. Rul. 81-95).

Because, by definition, all section 527 organizations are "political organizations," Form 990 should simply direct all section 527 organizations to complete Schedule C.

Principle 2: A filing organization should be required to track and report lobbying activity only if such activity can affect its tax liability or exempt status.

Lobbying is defined in different ways for different organizations, but for many section 501(c) organizations, lobbying has no impact on tax liability or exempt status. Reporting obligations for each type of organization should track these different legal requirements.

For organizations that can and should report on lobbying activities, the level of detail of reporting should match the degree of clarity with which lobbying is defined under current law. When the definitions are clear, as under section 4911, precise reporting is appropriate. When the definitions are unclear, as under the "insubstantial part" test, organizations should not be asked to do more than describe their activities accurately, but in general terms. Under no circumstances should any organization be expected to make legal judgments about its activities if the Service has not provided sufficient guidance to allow the organization to objectively evaluate the permissibility of those activities.

Principle 3: The Service cannot adequately address the lack of definitional clarity in some areas by using the definitions or instructions accompanying Form 990 or Schedule C to provide detail that should be developed through formal guidance.

In the interest of gathering information of interest that currently is unavailable, the Service may be tempted to use the Form 990 revision to adopt new rules or elaborate on definitions that have not been sufficiently developed. For example, the Service to date has provided little guidance about the limits of lobbying for non-electing public charities. Similarly, the Service has not yet acted on its intention, stated in 1988, to determine whether the section 527(f) tax applies to activities of a section 501(c)(3) organization attempting to influence the Senate confirmation of a federal judicial nominee.[8] Relying on this silence, organizations that attempt to influence federal judicial nominations generally presume that such activity is not subject to tax under section 527(f), and, to our knowledge, the Service has never imposed the tax on such activities. While exempt organizations would benefit from clear guidance about these and similar issues, Form 990 and accompanying documents are not the proper venue for the adoption of new definitions or changes in policy. Rather, such advancements should be accomplished through formal guidance that has been subjected to analytical scrutiny and public comment. That process will inevitably take time. Meanwhile, the redesign should acknowledge and accept the current state of the law and the limits it places on the reporting obligations the IRS can reasonably enforce.

[8] Notice 88-76, 1988-2 C.B. 392.

Following these three principles will enhance transparency and promote compliance by making clear to every organization exactly what rules it needs to follow and what activities it must report. This approach will also provide the public with information that can reliably be compared across organizations, since every organization will be using the same objective standards to determine what to report. Finally, the approach we propose will reduce unnecessary burdens on organizations by sparing them the need to gather and report on information that does not affect their tax status or exempt liability or provide the public with valuable, reliable information.

II. Line-by-Line Analysis and Specific Recommendations

A. Core Form 990

While our primary concern is Schedule C, we also must consider the questions on the core form relating to political campaign and lobbying activities, especially those that determine whether a filing organization will complete Schedule C.

1. Draft Form 990, Part VIII, line 1, Political Campaign Activities

a. Analysis

Draft Form 990, Part VIII, line 1 asks: "Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office?" A filer who answers "Yes" is directed to complete Schedule C, Political Campaign and Lobbying Activities.

"Political campaign activity" is defined in the Glossary as follows:

> All activities that directly or indirectly support or oppose candidates for elective federal, state, or local public office. 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 intended 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. 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.

This question and the related definition raise several concerns.

As discussed above in the Introduction, we think "political campaign activity" should be defined for purposes of the new Form 990 as in Reg. section 1.501(c)(3)-1(c)(3)(iii), which is the definition that applies to all section 501(c) organizations. Any activities that

are 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.[9] The same is true for all other section 501(c) organizations. (If political campaign activities are primary, the entity can only be tax-exempt under section 527 as a political organization.) Given that answering "yes" to this question triggers completion of Schedule C, in the interests of greater disclosure, we think it is appropriate to use section 501(c)(3)'s broad definition here.

The definition of "political campaign activity" should also address the significant differences between that term, as defined in federal tax law, and "express advocacy," as defined in federal election law, because some filers will be subject to both sets of rules and may be confused about which activities to report. Moreover, since the federal tax law concept of campaign intervention is considerably broader than the analogous concept under federal election law, the forms and instructions should highlight the importance of using the correct definition.

The words "direct" and "indirect," as used in Part VIII, line 1 and in the Glossary definition are not defined or discussed in the instructions, although their meaning can be inferred from the series of questions in lines 1-3 of Part I-C. However, the regulations under section 527 refer to "directly related" exempt function expenditures and "indirect expenses" with entirely different meanings.[10] We suggest avoiding use of confusing terms, but rather elucidating the concept the Service appears to be using in its request for information.

The word "intended" in the Glossary definition implies that evidence of subjective intent is relevant to a determination whether political campaign activities have occurred, which is contrary to IRS public statements.[11]

Finally, the definition of exempt function activities for section 527 organizations differs from the definition of political campaign activities applicable to organizations exempt under section 501(c) in several ways. For example, section 527 covers newsletter funds of officeholders, which may have little or no relationship to the election of any candidate to public office. Section 527 also covers attempts to influence the selection or appointment of officials who are not publicly elected, such as federal judges or officers in political parties. Influencing Senators on a judicial confirmation vote is considered

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[9] Reg. § 1.501(c)(4)-1(2)(ii); *see* PLR 9808037 (". . .[A]ny activities constituting prohibited political intervention by a section 501(c)(3) organization are activities that must be less than the primary activities of a section 501(c)(4) organization . . . .) *and* Rev. Rul. 81-95, 1981-1 CB 332.

[10] Reg. § 1.527-2(c).

[11] Internal Revenue Service, *Exempt Organizations Technical Instruction Program for FY 2002* at 352 (". . .[O]ne must look at what the organization was actually doing -- a conclusion based on some *a priori* "state of mind" determination would be improper. The most important thing to consider in determining whether an organization has participated or intervened in a political campaign is not the "motive" for the activity; rather, it is the activity itself.")

lobbying rather than political campaign activity for section 501(c)(3) organizations,[12] which means that until the Service provides guidance to the contrary, such activity should similarly not be considered political campaign activity for other section 501(c) organizations.

We believe that, rather than attempting to squeeze section 527 organizations into the basic definition of political campaign activities that applies to section 501(c), Part VIII should simply direct all section 527 organizations to complete the applicable portions of Schedule C.

b. Recommendations

(i) Reword Part VIII, line 1, to read (deletions marked in strike-out text, insertions underlined):

> Is the organization exempt under section 527, or d~~D~~id 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."

(ii) Revise the Glossary definition of political campaign activity as follows:

> All activities that ~~directly or indirectly~~ support or oppose candidates for elective foreign, national~~federal~~, state, or local public office, whether conducted by the organization itself, or through funding or other support of others' activities. It does not matter whether the candidate ~~is elected~~wins or loses the election. A candidate is one who offers himself or is proposed by others for the public office. Political campaign activity does not include any activity ~~intended~~ 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. ~~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.~~ Include all activities that support or oppose any candidate for election to a public office, whether or not such activities constitute express advocacy of the election or defeat of the candidate.

[12] Notice 88-76, 1988-2 C.B. 392 (lobbying on confirmation vote on nominee for federal judgeship constitutes attempting to influence legislation for purposes of IRC 501(c)(3), IRC 4911, and IRC 4945(d)).

2. Form 990, Part VIII, line 2, Lobbying Activities

a. Analysis

Draft core Form 990, Part VIII, line 2, asks: "Did the organization engage in lobbying activities? If "Yes", complete Schedule C." There is no draft instruction for this question, although the filer is directed to the Glossary, where lobbying is defined as follows:

> All activities intended to influence foreign, national, state or local legislation. Such activities include direct lobbying (attempting to influence the legislators) and grassroots lobbying (attempting to influence legislation by influencing the general public).

While this definition appears to make sense when viewed in isolation, the Code provides at least three different definitions of lobbying applicable to different types of tax-exempt organizations filing Form 990. Section 4911 provides a detailed definition of lobbying for public charities electing under section 501(h), including several significant exceptions that would be lobbying under the Glossary definition. Non-electing public charities must use the much less clear "insubstantial part" test stated in section 501(c)(3) but largely undefined through regulations or other guidance. Section 162(e) provides a definition that applies to some section 501(c)(4), (5), and (6) organizations, which explicitly excludes attempts to influence local legislation. Finally, for all other categories of section 501(c) organizations, there is no definition of or limitation upon lobbying in the Code or Regulations. Apart from the potential confusion created by a fourth definition in the Glossary, the draft question and definition would require many 501(c) organizations to complete Schedule C even though their lobbying activities are irrelevant to compliance with their exempt status, or their potential tax liability.

We recognize the value for transparency of requiring all organizations to describe their lobbying activities. We believe that Part IX, line 3, of the draft Form 990 serves that interest adequately by inviting the filer to describe its program service accomplishments. Organizations that are not required to complete Schedule C, because lobbying does not affect their exempt status or potential tax liability, have the opportunity to disclose any significant lobbying activity in Part IX.[13]

[13] Our comments are not meant to suggest any increase in reporting for section 501(c) organizations subject to the provisions of sections 162(e) and 6033(e). Form 990 should not require any section 501(c) organization to report lobbying expenditures or activities if the Code provides that no such reporting is required.

b. Recommendations

(i) Revise draft Part VIII, line 2, as follows:

"Section 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) organizations **only**: Did the organization engage in lobbying activities? If "Yes", complete the applicable portions of Schedule C."

(ii) Revise the entry for "Lobbying" in the Glossary as follows:

Lobbying is defined differently for different types of organizations. For section 501(c)(3) organizations that do not elect to use the section 501(h) expenditure test to measure their lobbying activity, lobbying includes all ~~All~~ activities ~~intended~~ that attempt to influence foreign, national, state or local legislation. Such activities include direct lobbying (~~attempting to influence the legislators~~ communications to legislative or other government officials) and grassroots lobbying (~~attempting to influence legislation by influencing~~ communications about legislation to the general public). For electing public charities, lobbying is defined in Regulation section 56.4911, including several exceptions. For section 501(c)(4), (c)(5), and (c)(6) organizations, lobbying is defined in section 162(e), which also includes some special rules and exceptions.

3. Draft Form 990, Part V, line 11(d), Lobbying as Functional Expense

a. Analysis

Draft Form 990, Part V, line 11(d) asks the filing organization to report fees it paid for services provided by non-employees for "lobbying." The accompanying instructions define "lobbying" to include "amounts for lobbying before federal, state, or local executive, legislative or administrative boards." This definition differs from the definition of "lobbying activities" that would trigger a "yes" answer to Form 990, Part VIII, line 2, and completion of Schedule C, since the main definition of lobbying in the instructions for Schedule C does not include actions directed at executive or administrative bodies.

The same words, used in different places in the same document, should have the same meanings. Using different definitions will confuse both filers trying to complete the form, and the public trying to understand the filer's activities. Different definitions also increase the risk of inconsistent and unreliable information being reported on the Form 990. The definition for Part VIII, line 2 is familiar to section 501(c)(3) organizations, who constitute the vast majority of Form 990 filers. It is also the

definition primarily used for Schedule C, whose focus is political campaign and lobbying activities.

b. Recommendation

(i) Revise the definition of "lobbying" in the draft instructions for Part V, line 11(d) as follows:

> Enter amounts for lobbying ~~and legislative liaison~~ services. Include amounts for lobbying on foreign, national, state, or local legislation ~~before federal, state, or local executive, legislative or administrative boards~~. Do not include activities to influence actions by executive, judicial, or administrative bodies.

B. Schedule C

1. Schedule C, Part I-A, Political Campaign Activity Description

a. Analysis

The draft Schedule C, Part I-A, asks filers to "provide a description of the filing organization's direct and indirect political campaign activities" but does not make clear that only organizations that answered "Yes" to Form 990, Part VIII, line 1, should complete Schedule C, Part I-A. Some organizations to which Part I-A does not apply will be completing other parts of Schedule C. While the draft instructions imply that filers who reported no political campaign activities in the core Form 990 need not complete Part I-A, the form itself should make this clear as well.

The draft instructions, under Definition of Terms, define "political campaign activities" in exactly the same words as the draft Form 990 Glossary does, with one significant exception. The final sentence of the draft Form 990 Glossary definition ("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.") has been moved to the line-by-line instruction for line 1, but with the addition of a reference to office in a political party: "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." It is unclear to us why the two definitions are different, and in the interest of consistency, we would keep them exactly parallel. Accordingly, the discussion above concerning our analysis and recommendations for the Glossary definition of political campaign activities also applies to the definition in the draft instructions.

Substantively, we see no basis for any section 501(c) organization to be required to report on Schedule C activities that support or oppose candidates for **appointive** offices. As

noted above, the Service has determined that for section 501(c)(3) organizations, such activities constitute lobbying, but are not political campaign activity. Specifically, the Service has stated that "attempts to influence the Senate confirmation of [a] federal judicial nominee do not constitute participation or intervention in a political campaign within the meaning of section 501(c)(3). . . ."[14] In keeping with the Service's position that the activities that are prohibited for section 501(c)(3) organizations are the same activities that must not be "primary" for other section 501(c) organizations,[15] no section 501(c) organization should be required to report in Part I-A of Schedule C on their activities related to attempts to influence confirmation votes.

Unlike the existing Form 990, the draft form and instructions say nothing about any relationship a section 501(c) organization may have with a separate segregated fund (SSF) formed under section 527(f)(3). Section 527(f) provides that an SSF constitutes a separate organization for purposes of calculating tax. The explanation on the existing form reflects the importance of this point for section 501(c) organizations with SSFs, making clear that the activities of the SSF should not be reported as activities of the section 501(c) organization. The revised form and instructions should be equally clear, to avoid the possibility of inconsistent or inaccurate reporting. Specifically, filers need to be informed that the SSF is subject to its own federal tax reporting and that expenditures of the SFF should not be reported by the section 501(c) organization. Filers should also be instructed that "prompt and direct" transfers of certain earmarked funds made under the Regulations should be disregarded, but that all other payments by the section 501(c) entity to or on behalf of the SSF should be reported here as the section 501(c) organization's political campaign activities and expenditures, unless the section 501(c) entity received reimbursement from the SSF within the tax year, or a *quid pro quo* from the SSF in exchange.

The existing Form 990 addresses the possibility that a section 501(c)(3) filer may have taxable expenditures under section 4955(d)(2) if it is used or controlled by a candidate. A similar reference is needed in the draft instructions.

Finally, for the small segment of section 527 organizations that are required to file Form 990, the IRS has reversed itself and now desires them 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 section 501(c) definition without making certain expressly-stated modifications. Section 527 organizations should be advised 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 engage in lobbying, in order to build alliances, attract members, increase favorable voter turnout, or influence the public's impression of the candidates.[16]

[14] *Id*. *See also* GCM 39,694 (1988).
[15] PLR 9808037.
[16] *See* PLR 199925051.

b. Recommendations

(i) Revise the heading for Part I-A, as follows:

> "To be completed by all organizations exempt under section 501(c) and section 527 organizations, if you answered "Yes" on Form 990, Part VIII, line 1. (See Schedule C instructions for details.)"

(ii) Revise the heading for Part I-B, as follows:

> "To be completed by all organizations exempt under section 501(c)(3), if you answered "Yes" on Form 990, Part VIII, line 1. (See Schedule C instructions for details.)"

(iii) Revise the definition of political campaign activities in the Definition of Terms in the draft instructions as follows:

> All activities that ~~directly or indirectly~~ support or oppose candidates for elective foreign, national~~federal~~, state, or local public office, whether conducted by the organization itself, or through funding or other support of others' activities. It does not matter whether the candidate ~~is elected~~wins or loses the election. A candidate is one who offers himself or is proposed by others for the public office. Political campaign activity does not include any activity ~~intended~~ 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. ~~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.~~ Include all activities that support or oppose any candidate for election to a public office, whether or not such activities constitute express advocacy of the election or defeat of the candidate.

(iv) Revise and expand the draft instruction for Part I-A, line 1, as follows:

> Provide a detailed description of the organization's political campaign activities. ~~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.~~ This information is needed 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 report using the definition of political campaign activities provided in the Definition of Terms above. Section 501(c)(3) organizations used or controlled by a candidate or prospective candidate should also include certain activities relating to that individual as set forth in section 4955(d)(2).

Section 501(c) organizations other than those exempt under section 501(c)(3) may establish separate segregated funds, subject to their own obligation to file separate tax returns, to engage in political activities under section 527(f)(3). The section 527(f)(3) 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 a section 527(f)(3) fund, and promptly and directly transfers them to that fund as prescribed in Regulations section 1.527-6(e), such amounts should not be reported here. Expenditures by a sponsoring section 501(c) organization that were reimbursed by a separate segregated fund within the sponsor's tax year should not be reported here. However, any other payments made by the section 501(c) organization sponsor to or on behalf of any section 527(f)(3) fund without consideration are regarded as the section 501(c) organization's political campaign activities and should be reported here.

Section 527 organizations, including separate segregated funds, should report on their political campaign activities as defined above, with the following modifications: (1) exclude 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.

2. Schedule C, Part I-A, Volunteer Hours

a. Analysis

Draft Schedule C, Part I-A, asks all filing organizations to report the number of hours of volunteer labor used in the conduct of the filer's political campaign activities. The instructions provide no additional guidance about what constitutes "volunteer" labor.

Even without any political expenditures, a charity's political campaign activities using volunteers could violate section 501(c)(3). Likewise, taking into account a non-charitable section 501(c) organization's volunteer hours could result in a different determination of the organization's primary activity than an assessment based only on expenditures. However, the IRS has never before used Form 990 to require reporting of volunteer hours devoted to political campaign activity.

The use of volunteers by tax-exempt organizations is common, varied and usually difficult to track. Most organizations do not have a volunteer hour tracking system in place, and this question would impose on all politically-active exempt organizations mandatory tracking of volunteer time. This represents a potentially huge burden on these organizations.

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.

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 would indicate that political activity is primary; in others, 5,000 hours of campaign work could be a small fraction of the organization's total program activity. Reporting this number without context could mislead the public about the overall nature of an exempt organization's activities. Moreover, in its own defense, an organization would need to collect volunteer hours on all of its activities in order to put political campaign hours in proper perspective.

The question on the current draft imposes significant burdens on filing organizations without providing the Service with reliable information to evaluate compliance with the filer's tax-exempt status or potential tax liability. These burdens outweigh any possible benefit that would result from the collection of unreliable estimates of volunteer hours in the absence of any objective basis for measurement or comparison.

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 activation program from membership lists, electronic records, expenditures made, and other visible evidence.

b. Recommendation

(i) Delete as follows from Part I-A, line 1:

~~Volunteer hours . . . . . .~~ _____

3. Schedule C, Part I-C, Re: "Own Internal Funds" and Calculation of Section 527(f) Exempt Function Expenditures

a. Analysis

A section 501(c) organization other than a section 501(c)(3) organization must calculate its "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 purport to lead the filer through this calculation of exempt function expenditures, but the draft language in Part I-C is unclear in some significant respects, potentially leading to calculation errors and, therefore, inaccurate tax assessments.

Draft Part I-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 describe these same expenditures. A similar phrase is used in the draft instructions for Schedule C, Part II-B, referring to grants (line 1f) and public forums (line 1h) paid out of the organization's "own internal funds." In the 2006 Form 990, the term "its own funds" appears in the instructions for 501(c) organizations reporting political expenditures on line 81a.

There is no Code section or Regulation defining the term "own internal funds" or "its own funds" in relation to political or lobbying activities.

These phrases are probably the result of Reg. section 1.527-6(e), promulgated under section 527(f)(3), which refers to political contributions or dues collected (typically from members) by a section 501(c) organization and then promptly and directly transferred to an SSF. 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 an 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 unnecessary in a tax reporting form and 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 under-reporting of taxable amounts. The form and instructions should require filers to clearly identify the non-taxable prompt and direct transfers to SSFs, and all other expenditures should be reported without any extra verbiage regarding the source of funds.

As drafted, lines 1, 2, and 3 use confusing and inaccurate terminology, such as "directly expended," "own internal funds," and "direct and indirect." Line 3 incorrectly suggests that "indirect" expenses count as exempt function expenditures. On the contrary, Regulations section 1.527-6(b) establishes that indirect expenses are not considered exempt function expenses for a section 501(c) organization, and are not subject to tax. Furthermore, the draft overlooks Regulations section 1.527-6(b)(3), which excludes 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 their members.

A more accurate, clear approach is to begin with the total expenditures for political campaign activities reported in Part I-A. Expenses to influence judicial and other appointments can be reported on line 1 and added to that total. Political campaign expenditures that a section 501(c) organization may engage in without incurring tax liability could be reported on line 2 and subtracted from the total.

b. Recommendations

(i) Revise the heading for Part I-C, as follows: "To be completed by all organizations exempt under section 501(c), except section 501(c)(3), if you answered "Yes" on Form 990, Part VIII, line 1. (See Schedule C instructions for details.)

(ii) Revise lines 1, 2, and 3 as follows:

1 Enter the amount, if any, ~~directly~~ expended by the filing organization ~~for section 527 exempt function activities~~ to influence the election or appointment of candidates for public offices or offices in political organizations.

2 Enter the ~~amount~~ sum of the ~~filing organization's own internal funds contributed to other organizations for section 527 exempt function activities~~ 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.

3 ~~Total of direct and indirect exempt function expenditures. Add lines 1 and 2 and~~. 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.

(iii) Revise the draft instruction for Part I-C, line 1, as follows:

"Enter the amount ~~of its own funds~~ that the organization expended for political campaign activities. Do not include expenses of appearances 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."

(iv) Revise the draft instruction for Part I-C, line 2, as follows:

"Enter the amount ~~of its own funds~~ that the organization transferred to other organizations including a separate segregated fund created by the organization."

(v) Delete as follows from the draft instructions for Part I-C, line 3:

~~Total of direct and indirect exempt function expenditures. Add lines 1 and 2 and enter on line 3 and on Form 1120-POL, line 17b.~~

4. Schedule C, Part I-C, line 5, Reporting Payments to 527 Organizations

a. Analysis

Draft Part I-C, line 5, 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).

No IRS tax form has ever required section 501(c) organizations to report such payments to section 527 organizations. As drafted, there is no minimum threshold for reporting these 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, is extremely burdensome, without apparently furthering any of the Service's other goals in the redesign process. Furthermore, the draft is not clear whether the section 501(c) organization should include payments to a section 527 organization made in return for goods or services in a *quid pro quo* exchange. This must be clarified to ensure consistent reporting; we favor excluding such *quid pro quo* payments to give a clearer picture of the filer's support of section 527 organizations.

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. This information should be sufficient to apprise the IRS of the major financial relationships that a 501(c) filing organization may have with 527 organizations, without requiring every $200 or even $10 donation to a candidate's committee to be listed.

b. Recommendation

(i) Revise Part I-C, line 5, to read as follows:

State the name, address and Employer Identification Number (EIN) of ~~all~~ those section 527 organizations to which ~~payments were made~~ the filing organization transferred $50,000 or more without consideration. Include only the recipients of the five largest amounts. In column (d), ~~E~~enter the amount transferred, if any, that constituted ~~paid and indicate if the amount was paid from the filing organization's own internal funds or were~~ political contributions or dues received and promptly and directly transferred to ~~a separate~~ the section 527 ~~political~~ organization ~~such as a separate segregated fund or a political action committee (PAC)~~. In column (e), enter the total of all other amounts transferred without consideration, if any, to that section 527 organization. If additional space is needed, attach a separate sheet.

(**ii)** Revise the draft instructions for Part I-C, line 5, to read:

Amounts listed in column (d) are not treated as the income or expenses of the filing organization, and would not be included in the total of its political expenditures reported on Part I-A, line 1. See Regulations

section 1.527-6(e). Amounts listed in column (e) should be included in the total of political expenditures reported on Part I-A, line 1.

5. Schedule C, Part II-B, Lobbying Activity of All Section 501(c) Entities

a. Analysis

Draft Schedule C, Part II-B, is supposed to be completed by all section 501(c) entities except section 501(c)(3) organizations that made the section 501(h) election. Filers 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. Existing Form 990, Schedule A, collected this information, but only from non-electing public charities. As noted above, 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 Code section 6033(e) as enacted, but the Service has declared that only section 501(c)(4), (c)(5), and (c)(6) organizations are subject to the proxy tax requirements.[17] Those organizations' reporting requirements are addressed in Schedule C, Part III.

Requiring non-charitable section 501(c) organizations to describe their lobbying activities at this level of detail does not promote compliance, because such activities have no impact on the tax-exempt status or potential tax liability of these organizations. Nor does such reporting enhance transparency in any meaningful way, since, as noted above, significant lobbying by these organizations will be disclosed on Form 990, Part IX, line 3. The proposed reporting requirement increases the burden on exempt organizations to track details of their lobbying activities without providing any tangible benefit to the Service or the public.

b. Recommendation

(i) Revise the heading for Schedule C, Part II-A, as follows:

To be completed by organizations exempt under section 501(c)(3) that **both**: a) answered "Yes" on Form 990, Part VIII, line 2, **and** b) filed Form 5768 (election under section 501(h)). (See Schedule C instructions for details.)

(ii) Revise the heading for Schedule C, Part II-B, as follows:

[17] Rev. Proc. 98-19, 1998-1 C.B. 547.

To be completed by organizations that **both**: a) answered "Yes" on Form 990, Part VIII, line 2, **and** b) are exempt under section 501(c) **except** those organizations exempt under section 501(c)(3) that filed Form 5768 (election under section 501(h)). (See Schedule C instructions for details.)

6. Schedule C, Part II-B, Line 2, concerning Insubstantial Part Test

a. Analysis

Draft Schedule C asks non-electing section 501(c)(3) organizations to report their lobbying activities on Part II-B, which differs significantly from the corresponding part of the existing 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 draft 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 tax under section 4912, which is imposed on the disqualifying lobbying activities of section 501(c)(3) organizations.

Section 501(c)(3) provides exemption from federal income tax to an organization "no substantial part of the overall activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. . . ." Section 501(c)(3) and the Regulations thereunder provide little guidance about how much activity constitutes a "substantial part" of an organization's "overall activities," or about what activities must be measured. 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 is no longer described in section 501(c)(3), and therefore risks losing its tax exemption, and owes tax under section 4912.

This combination of extreme uncertainty and grave risk precludes meaningful self-evaluation and places the filing organization in the untenable position of having to guess whether the IRS would, under all of the relevant facts and circumstances, consider the organization's lobbying activities to constitute a "substantial part" of its "overall activities."

A charity that answers "Yes" to the question in line 2a would be admitting that it violated its tax-exempt status, whether it owed and paid tax under section 4912 or not, without any objective basis for determining the accuracy of its conclusions.

Consequently, most organizations will answer "No" if they believe they have a reasonable basis for considering their lobbying activity to be insubstantial. However, if the Service later determines that the organization did engage in excessive lobbying such

that the organization was no longer described in section 501(c)(3), the organization may be found to have made a false statement on its return, even though it answered in good faith, given its interpretation of murky existing guidance.

Until the Service issues comprehensive guidance that describes the meaning of "substantial" and defines "attempting to influence legislation" in this context, charities cannot be expected to determine on their own whether they have engaged in substantial lobbying activities. A non-electing public charity that is uncertain about the extent of its lobbying should not be forced to choose between making a false statement on its return or making an admission that it violated its exemption. Rather, the Service should ask filers to accurately describe their activities, and leave the evaluation of substantiality to examinations.

b. Recommendation

(i) Revise Part II-B, lines 2a-d, as follows:

~~Line 2a. Did the activities in line 1 cause the organization to be not described in section 501(c)(3)?~~
~~Line 2b. If "Yes," enter the amount of any tax incurred under section 4912~~
~~Line 2c. If "Yes," enter the amount of any tax incurred by organization managers under section 4912~~
~~Line 2d. If the filing organization incurred a section 4912 tax, did it file Form 4720 for this year?~~

III. Summary of Key Recommendations

Form 990:

1. Define "political campaign activity" to coincide with the definition of activity that is prohibited for section 501(c)(3) organizations.

2. Define "lobbying" by reference to the definitions provided in the Code and Regulations for the different types of exempt organization.

3. Refer all section 527 organizations to Schedule C.

Schedule C, Part I-A:

4. Expand the instructions to provide clarity about what political campaign activities should be reported by different types of exempt organizations, especially to clarify that section 501(c) organizations should not report expenditures made, or reimbursed within the tax year, by a sponsored separate segregated fund.

5. Eliminate reporting of volunteer hours by all reporting organizations.

Schedule C, Part I-C:

6. Revise the instructions to coincide with the definition of "exempt function expenditures" under section 527.

7. Revise Part I-C to limit reporting by section 527 organizations to major expenditures.

Schedule C, Part II-B:

8. Eliminate lobbying expenditure reporting for section 501(c) organizations other than section 501(c)(3), (4), (5) and (6) organizations.

9. Eliminate requirement for section 501(c)(3) organizations to determine whether their lobbying is "substantial."

* * * * * *

IV. Conclusion

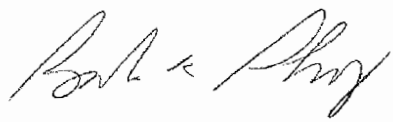
We and our clients recognize the many challenges posed by the Form 990 redesign effort, and applaud the Service for undertaking this much-needed, if daunting, project. We hope that these comments are helpful, and look forward to seeing the results of this complicated but valuable process.

Very truly yours,

Gregory L. Colvin

Rosemary E. Fei

David A. Levitt



Barbara K. Rhomberg

Eric Gorovitz

cc: Humane Farming Association
Olson, Hagel & Fishburn, LLP
Planned Parenthood Affiliates of California
PowerPAC.org
Service Employees International Union Local 1000
Washington Education Association

From:	Hugh Graham
To:	*TE/GE-EO-F990-Revision; Lerner Lois G; Schultz Ronald J; Livingston Catherine E;
CC:	
Subject:	Comments on Form 990, Schedule A and Form 8734
Date:	Friday, September 14, 2007 8:16:45 PM
Attachments:	Comments on Form 990 Schedule A and Form 8734 (00063181).PDF

<<Comments on Form 990 Schedule A and Form 8734 (00063181).PDF>>
Attached please find our firm's comments on the proposed redesign of Form 990, Schedule A and the proposed elimination of Form 8734.

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Any tax advice contained in this email was not intended to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under federal tax law. A taxpayer may rely on our advice to avoid penalties only if the advice is reflected in a more formal tax opinion that conforms to IRS standards. Please contact us if you would like to discuss the preparation of a legal opinion that conforms to these rules.

=====

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September 14, 2007

VIA E-MAIL

Ms. Lois G. Lerner
Director, Exempt Organizations Division, Internal Revenue Service

Mr. Ronald J. Schultz
Senior Technical Advisor to the Commissioner of TE/GE

Ms. Catherine E. Livingston
Deputy Associate Chief Counsel (Exempt Organizations)

Ms. Theresa Pattara
Project Manager, Form 990 Redesign, SE:T:EO

Internal Revenue Service
Form 990 Redesign, SE:T:EO
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: **Comments on Proposed Redesign of Form 990, Schedule A and Proposed Elimination of Form 8734**

Dear Ms. Lerner, Mr. Schultz, Ms. Livingston, and Ms. Pattara:

We appreciate the opportunity to submit comments on the proposed redesign of Form 990, Schedule A and the proposed elimination of Form 8734. Others at our firm are submitting separate comments concerning the proposed redesign of Form 990, Schedule C.

Overall, the new Schedule A is a much better design, in that it focuses exclusively on 501(c)(3) public charities. The proposed new form draws clearer distinctions between the types of public charities and the requirements for each to maintain their status. The separate public support test schedules, and the explicit questions regarding under which test a publicly supported charity qualifies, are very helpful.

However, we have the following concerns about the proposed Schedule A changes that affect the public support tests and the proposed elimination of Form 8734:

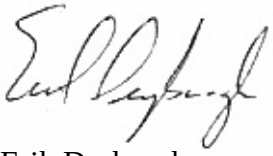
1) **Some organizations may find it more difficult to pass the public support test using the accrual method; the cash method should remain an option explicitly stated on Form 990, Schedule A.** Some organizations receiving multi-year grants would have increased difficulty passing the public support tests using the accrual method. Form 990, Schedule A and any changes to the regulations should make it explicitly clear that organizations can use either the accrual or cash method, as long as they use they same method for all five years in the same Form 990 measurement period.

2) **Proposal to eliminate Form 8734 may jeopardize donor privacy.** Filers of Form 8734 are currently required to attach a list of excess contributors that ties to the support schedule for their advance ruling period. The excess contributors schedule should continue to be required at the end of the advance ruling period to confirm the charity's public support calculations. Otherwise, the Service's ability to monitor compliance would actually diminish and incorrect calculations would go unchecked. However, if Form 8734 were eliminated and filers used the support schedule on Form 990, Schedule A to request a final determination of their public charity status, then it would follow that the list of excess contributors would have to be attached to the Form 990. This could jeopardize donor privacy.

3) **Proposal to eliminate Form 8734 may create delays in funding for charities.** Currently Form 8734 must be filed 90 days after the end of an organization's advance ruling period, and the Service typically issues final determination letters within a response time of two months. However, the timeline to file Form 990 is much longer; filers needing a 2nd extension have more than 9 months after the end of a tax period to file their returns. Although IRS determination letters granting an advance ruling period clearly say that grantors and donors may rely on the advance determination so long as organizations file Form 8734 within 90 days, many grantors and donors do not understand the nuances involved and are reluctant to commit funding to an organization until it has received its final determination letter. If the issuance of the final determination letter is delayed until after the Form 990 filing deadline, then the period of uncertainly and hesitation for grantors and donors would be much longer.

Please find our detailed comments and recommendations in the following attached pages. We hope that our comments are helpful, and we applaud your efforts in this significant undertaking.

Very truly yours,



Erik Dryburgh

Hugh G. Graham
Client Finance Administrator

DETAILED COMMENTS ON FORM 990 SCHEDULE A
SILK ADLER & COLVIN

Part I, Reason for Public Charity Status

Title and introductory sentence: The title of this part is much clearer than "Non-Private Foundation Status", and lends a positive tone versus negative. However, the first line then says: **"The organization is not a private foundation because it is"**. Also, the 2006 Form 990 required the entity to "certify" its status as follows: **"I certify that the organization is not a private foundation because it is:".** The phrase "I certify" was added to the 2006 Form 990 as part of the Pension Protection Act changes, presumably to create a reliance mechanism for supporting organizations whose type is not identified by their IRS determination letters.

Recommendation:

- Use the same assertive language as the title and include the "certify" language so this reads: **"I certify that the organization is a public charity because it is:"**.

Line 7: The language for Line 7 has not changed from the current Form 990: "An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Complete the *Support Schedule* in Part II.)" There is often confusion about which public support test the filer should use, partially due to the absence of any reference to 509(a)(1) and the emphasis on receiving support from a governmental unit.

Recommendation:

- Change to: "**An organization that normally receives a substantial part of its support from gifts, grants and contributions. Such support may come from a combination of governmental, private, or public sources. Section 170(b)(1)(A)(vi) and 509(a)(1). (Complete the *Support Schedule* in Part II.)**"

Line 11h(i), "Name of Supported Organization" and (vii) "Amount of Support": This information is already required on the 2006 Form 990. For supporting organizations that provide support by means of grants, the name of each supported organization and amount of support will be duplicative of the information provided in Schedule I, Part II. Because some information required in line 11(h) is duplicative to Schedule I, Part II, some filers may response with "See Schedule I" without answering additional questions in column (iv) through (v). Also, if the number of supported organizations exceeds the space allowed on the Schedule A form, some filers may attach a statement in order to respond completely. These duplicative reporting requirements may be burdensome to some filers as well as users of the Form 990.

Also, instructions say "**List the name and employer identification number for each supported organization even if no monetary support was provided to the supported organization.**" These instructions are inherently problematic for supporting organizations whose governing documents describe a class of organizations that it supports. Obviously a

supporting organization filer that supports a class of organizations is not expected to list all possible organizations within its defined supported class.

Recommendations:

- Change **Line h** to: "**Provide the following information for each supported organization named in your governing document, even if no monetary support was provided to the supported organization.**" In the schedule following line h, retain all columns except column (iv), which can be deleted because of the re-wording of this question.

- Add a new **Line i** that will read: "**If the supporting organization supports a class of supported organizations, provide the text from the organization's governing documents that define its supported class.**" A minimal space of three lines should be provided for this text.

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

GENERAL COMMENTS

Change from Four Year to Five Year measurement period: Extending the measurement period to 5 years could both help and hurt public charities. In most cases, this will help most public charities, because they will now have a longer measurement period for calculating their public support. The five year period could smooth out some peaks and valleys caused by multi-year grants counted as received in their entirety in one year under the accrual method. It also fixes the problem of having to use a five year measurement period when a "substantial and material change" has occurred (per Rev. Proc. 81-6 and Rev. Proc 89-23).

However, depending on the size and timing of an organization's grant awards, the five year period could also result in more "tipping" problems because large grants will linger in the measurement periods for 1 year longer than they would under the current 4 year measurement period. See further comments as follows regarding the proposed elimination of the cash method.

Elimination of requirement to use cash method: Although this may be a welcomed change by some tax preparers and organizations who find it difficult to adjust their accrual basis revenue figures to cash basis figures, the potential material effect of using the accrual method for some organizations deserves careful consideration.

The proposed change would make it vastly less complicated for many organizations to complete the support schedule, and therefore it meets with the Service's guiding principle of reducing burden on many Form 990 filers.

However, using the cash method instead of the accrual method can make a material difference in passing the support test. We assume that although the Service proposes the elimination of the *requirement* to use cash method, the cash method is still allowable, and we urge the Service to make it clear that public charities can use either method.

In some cases, being able to use the cash method may make the difference between passing and failing the test. Under the proposed 5 year measurement period, the tipping effect for large multi-year grants would have more impact using the accrual method than the cash method, because under the cash method earlier installments of large grants would fall outside of the measurement period sooner. In short, because the measurement period will be 5 years instead of 4 years, there is more potential when using the accrual method for failing the public support test two years in a row.

Example of Tipping Effect from Multi-year Grants: Consider the following fact pattern. A public charity organization receives a 3-year grant of $300,000 from a private foundation to be disbursed in installments of $100,000 each year. This grant is renewed every three years.

Illustration 1, Organization passes 10% minimum under cash method (see following page)
Under the cash method, the organization counts $100,000 received from the private foundation in each year of any 5 year measurement period for a total of $500,000. Illustration 1 shows public support calculations over six measurement periods. The organization will need to receive support from four other contributors totaling $43,478 to maintain a minimum 10% public support percentage.

Illustration 2, Organization fails 10% minimum under accrual method (see following page)
The support from four other contributors totaling $43,478 in Illustration 1 is kept constant. Under the accrual method, the organization counts $300,000 from the private foundation as support in Year One, $0 from the private foundation as support in Years Two and Three, $300,000 from the private foundation as support in Year Four, $0 from the private foundation in Year Five, and so on. Illustration 2 shows public support calculations over the same six measurement periods as in Illustration 1. Recalculating public support using the accrual method results in fluctuating public support percentages due to the multi-year grant awards being counted only every three years. As a result, an organization receiving multi-year grants could fail to meet the 10% minimum public support requirement two years in a row using the accrual method, whereas it would pass the public support test using the cash method.

Illustration 3, Organization passes 10% minimum under accrual method (see following page)
The 3-year private funding pattern described in Illustration 2 is kept constant. In order to pass the 10% minimum required for the facts and circumstances test, the organization would need to receive support from five other contributors totaling $45,475, an increase in the overall number of additional contributors needed and a 4% increase in the amount of overall funds needed to be raised. Although less support is needed from each contributor, the fundraising efforts required to secure an additional contributor would likely outweigh any beneficial effects of having to raise less from each person. This illustrates how using the accrual method actually raises the bar of support needed to pass the public support test.

ILLUSTRATION 1 – CASH METHOD

Measure-ment Period	Multi-year grant ($'s)	Support needed from four other contributors (constant)	Public Support (%-ages)
Years 1-5	500,000	10,870	10.00%
Years 2-6	500,000	10,870	10.00%
Years 3-7	500,000	10,870	10.00%
Years 4-8	500,000	10,870	10.00%
Years 5-9	500,000	10,870	10.00%
Years 6-10	500,000	10,870	10.00%

Total support from four other contributors: $43,478

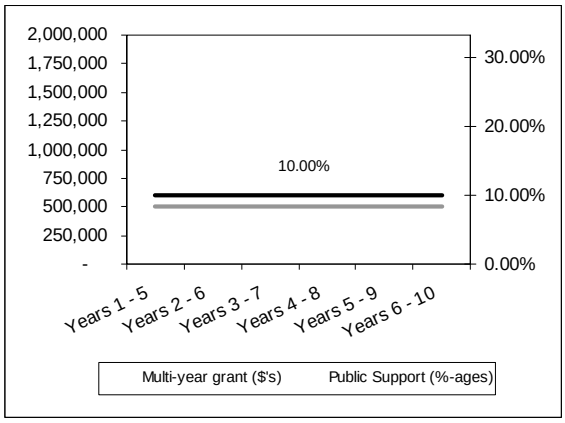


ILLUSTRATION 2 – ACCRUAL METHOD

Measure-ment Period	Multi-year grant ($'s)	Support needed from four other contributors (constant)	Public Support (%-ages)
Years 1-5	600,000	10,870	8.45%
Years 2-6	300,000	10,870	15.82%
Years 3-7	600,000	10,870	8.45%
Years 4-8	600,000	10,870	8.45%
Years 5-9	300,000	10,870	15.82%
Years 6-10	600,000	10,870	8.45%

Total support from four other contributors: $43,478

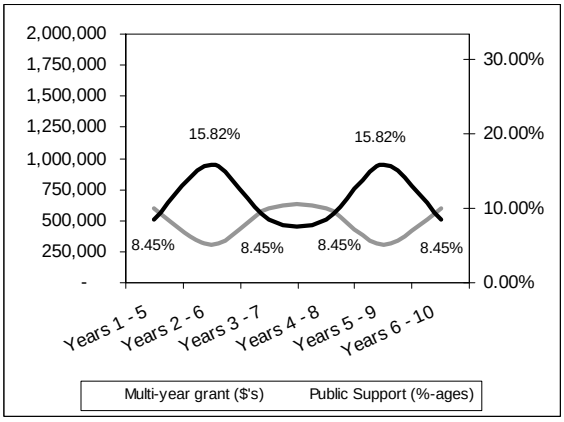
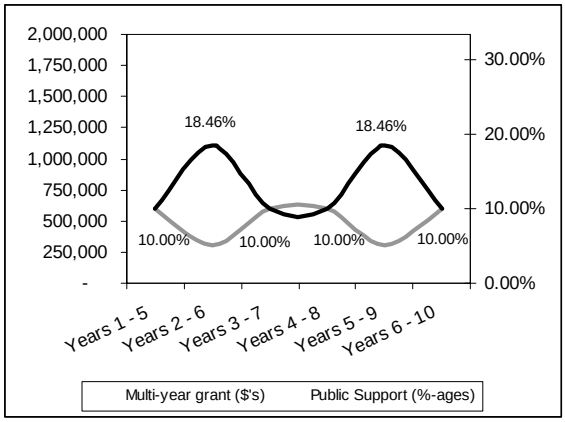


ILLUSTRATION 3 – ACCRUAL METHOD

Measure-ment Period	Multi-year grant ($'s)	Support needed from five other contributors	Public Support (%-ages)
Years 1-5	600,000	9,095	10.00%
Years 2-6	300,000	9,095	18.46%
Years 3-7	600,000	9,095	10.00%
Years 4-8	600,000	9,095	10.00%
Years 5-9	300,000	9,095	18.46%
Years 6-10	600,000	9,095	10.00%

Total support from five other contributors: $45,475



In other words, under the accrual method the potential "tipping" effect from private foundations or individual donors who make multi-year grants/pledges will be amplified. The total amount of a multi-year gift will be counted as income received in one year instead of installments received over two or more years. A large award counted in its entirely in one year using the accrual method will skew all five years that it is counted as part of the public support measurement period instead of the gradual effect of installments being counted in the year they are received using the cash method.

Should the requirement to use the cash method be removed, paid tax preparers and tax software programmers may default on using the accrual basis without realizing that the cash method is still an option. This de facto imposition of the accounting industry's preferred bookkeeping methods should not be allowed to raise the bar of support needed to pass the public support test.

Recommendations:

- At the top of Part II, add the following: "**Indicate which method is used in preparing the support schedule: □ Cash or □ Accrual**".

- Add an explicit statement to the instructions informing filers that they may use either the cash or accrual method in preparing the support schedule. Instructions should clearly state that the method used can change from one Form 990 filing year to the next, but an organization must use the same method for all five years in one Form 990 measurement period.

SPECIFIC COMMENTS

Title: There is often confusion about which public support test the filer should use, partially due to the absence of any reference to section 509(a)(1).

Recommendation:

- Change to "**Support Schedule for Organizations described in IRC 170(b)(1)(A)(iv) and Organizations described in 170(b)(1)(A)(vi) and 509(a)(1)**".

Line 1: currently reads: **"Gifts, grants and contributions received (Do not include any "unusual grants.")** There is no longer a line for listing amounts from unusual grants, and the attachment required by the instructions is not referenced on the form. At a minimum, filers should be alerted to read instructions for further information about unusual grants.

Recommendation:

- Change to "**Gifts, grants and contributions received (Do not include any "unusual grants." See instructions.)**".

Line 3: This no longer includes language on the current Form 990 Schedule A which reads: **"Do not include the value of services or facilities generally furnished to the public without charge"**

Recommendation:

- Either add back current language, "**Do not include the value of services or facilities generally furnished to the public without charge"**, or add "**See instructions**" and provide more guidance in the instructions.

Membership fees received (deleted): The current Form 990, Schedule A support schedule includes a line for "membership fees received", presumably in recognition that organizations may mistakenly report gifts, grants and contributions under "memberships". Removing a "membership" line from the proposed new support schedule is problematic. The use of terms such as "Membership Drive", "Annual Memberships", "Annual Subscriptions" and other similar phrases are commonly used by public charities in their fundraising efforts to attract individual donations, even though the charity may not have any actual "members" in the legal corporate sense and amounts paid do not give donors rights to any tangible benefits. Public charity filers will likely continue to report gifts, grants and contributions under "Membership dues and assessments" on the core Form 990, page 1, Part I, line 13 and page 5, Part IV, line 3, even though current Form 990 instructions explain that this line is most appropriate for 501(c)(5), (6), and (7) organizations. Removing a "memberships" line from the support schedule will not solve this reporting problem, but rather it will create an inconsistency between income lines provided on the core Form 990 and the support schedule. This may result in some filers underreporting their actual public support.

Recommendation:

- Re-insert a line to capture contributions that are mistakenly reported as "Membership dues and assessments" on page 1, Part I, line 13 and page 5, Part IV, line 3 of the core Form 990. The line should read: "**Membership fees (Contributions without any tangible benefits). See instructions.**" Instructions for Schedule A should reiterate the distinction between membership fees and contributions that are made in the instructions to the core Form 990. Filers should be further instructed to report any amounts paid in return for tangible benefits under line 13.

Line 4: currently reads: "**Total**"

Recommendation:

- Change to: "**Subtotal (Add lines 1 through 3**)"

Line 10: currently reads: "Gross receipts from activities that are not an unrelated trade or business under section 513." This line is included in total support but not public support, and therefore any amounts reported would have a negative effect on the public support percentage. Instructions give examples of qualified public entertainment activities and fundraising events. On the current Form 990, gross revenues from fundraising events are reported on line 17 of the support schedule and excluded entirely from the 170(b)(1)(A)(vi) and 509(a)(1) public support

test. Organizations should not be penalized in their public support test calculations for actively conducting fundraising events; indeed, conducting an active fundraising program is one of the public support factors in the facts and circumstances test.

Recommendation:

- Add a new line specifically for fundraising events and exclude the support from the calculation, or clarify in the instructions that these amounts should be included in line 13 and therefore excluded from the 509(a)(1) and 170(b)(1)(A)(vi) calculations.

Part III, Support Schedule for Organizations Described in IRC 509(a)(2)

No comments

Comments about Proposed Elimination of Form 8734

Eliminating Form 8734 would be problematic for the following reasons:

1) **Turnaround of final ruling letters and grantor/donor reliance**. Determination letters for advance ruling periods currently provide that grantors and donors may rely on the determination until 90 days after the end of the advance ruling period. Form 990 is not required to be filed until the 15th day of the 5th month after the end of a fiscal period, and many organizations file on extension. Using Form 990 instead of Form 8734 for the end of advance ruling period filing would mean a longer delay in organizations receiving their final determination letters and could cause complications or delays in securing funding commitments from grantors or donors.

2) **Confidentiality of Donor Information.** Donor privacy is a critical concern, as Form 8734 and the list of excess contributors which is required to be attached to Form 8734 is currently not subject to the same public disclosure rules as the Form 990. If Form 8734 was eliminated, then the Form 990 instructions would presumably require the same list of excess contributors be attached for an organization filing a support schedule for the end of its advance ruling period. Attaching the list of excess contributors to Form 990 would jeopardize donor confidentiality unless non-disclosure systems could be implemented similar to those in place for Schedule B.

Recommendation:

- Form 8734 should not be eliminated, and the process of filing a support schedule for an initial five year advance ruling period (or 60-month advance ruling period for private foundation terminations) to obtain a final determination letter should remain unchanged.
