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To: [*TE/GE-EO-F990-Revision;](#)
CC:
Subject: Comments on Form 990 redesign
Date: Friday, September 14, 2007 4:41:36 PM
Attachments: [Comments on Form 990 Redesign \(Peter Gulia\).pdf](#)
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Comments on Form 990 redesign

Like the great success of the recent Form 1023 revision, the redesign of Form 990 is clear and helpful.

In submitting a few technical comments, I recognize that, in the interest of releasing a discussion draft for comment, the Service might have spent less time on the draft instructions than on the layout of a form or schedule. My comments guess at the information the Service wants (or should want) to elicit.

Although I serve some charities as a director and others as a lawyer, this comment letter is my own, and not on behalf of any client.

M - State of legal domicile (Governing State law)

For a charitable trust, it might be impossible to determine only one “State of formation”; for example, a trust’s creators might have signed many counterparts of the original trust document in many different States. Further, even if a trust was created in only one place, that place might have no other relevance to the trust’s administration.

The instructions should tell the filer to answer this item by naming which State’s law governs the trust’s administration. The instructions should say that a filer is permitted to assume that a governing-law clause in the trust document is legally effective, or, if there is no governing-law clause, to make a good-faith finding about which State’s law is most likely to govern the trust’s administration.

Because a corporation's "domicile" might be its State of incorporation or the State of its principal place of business (or both), it might be more clear to caption this item "Governing State law".

Part II Section A Column A (City and State of residence)

Before agreeing to serve as a director or trustee of a charity, a prudent person evaluates the potential liability and other risks of that fiduciary service. A requirement to report even the city of one's residence would screen out some capable people who otherwise could be willing to serve.

If the Service finds that it's important for a reader of Form 990 to have a means of communicating with an organization's director or trustee that's independent of the organization's staff, the Service could permit reporting of an address of an accounting firm, law firm, or other agent (other than the exempt organization) that is the reported-on person's agent for receiving communications concerning the exempt organization.

If the Service finds that it's important for a reader to know how "local" an organization's fiduciaries are, Form 990 could include a question asking the *number* of members of the governing body who are residents of the service area of the exempt organization. (It wouldn't make sense to ask this by reference to the organization's registered or principal office because such an office often has no relation to the area of the exempt organization's activities.)

Part II Section B Line 5 (family and business relationships)

The instructions should clarify whether a filer must (or need not) report a relationship between persons listed in Section A if that relationship has no possibility of affecting a transaction with the exempt organization.

The instructions should clarify the knowledge expected of a filer:

That Form 990 seeks the information sought in Line 5 does not by itself impose on an organization a duty to obtain the information asked for. Instead, an organization's duty to obtain information is provided by

relevant Federal and State laws and the organization's bylaws and conflict-of-interest policy.

Example: Alan is an architect and Linda is a lawyer. Alan sometimes gets Linda's advice about Alan's duties and obligations concerning a design or construction project, none of which relates to the charitable organization of which both are trustees. There is no business associated with either Alan or Linda that does business with the exempt organization. Although there is a business relationship between Alan and Linda, it does not affect any decision of the charitable organization, and there was no reason for Alan or Linda to disclose their relationship to the other trustees.

The organization must respond to this query based on the organization's knowledge, including constructive knowledge. However, information does not become the knowledge of the organization merely because it is known to a governing board member. But information discussed or disclosed in a meeting of the board or otherwise of the organization is known to the organization.

Part III (Statements Regarding Governance, Management, and Financial Reporting)

1b) This query needs a corresponding instruction that defines and explains what causes a director, trustee, or other governor to lack independence.

In doing so, the instruction should recognize that many boards will have someone who's conflicted concerning one decision (and properly recuses himself or herself from that decision), but is free of conflict concerning other decisions.

Here's a suggestion for an instruction:

For this line, a governing board member was not independent if he or she

- received compensation reported (or required to be reported) in Part II,
- had a conflict of interest (within the meaning of 26 C.F.R. § 53.4958-6(c)(1)(iii), and without regard to his or her recusal) regarding
 - a person who or that is or was a subject of information reported (or

required to be reported) in Part II and received more than \$100,000 of reportable compensation, or regarding

- transactions involving 15% (or more) of the expenses reported in this Form 990.

3b) The line instruction should include a clarification:

.... The number to be reported is of those transactions involving a conflict (even if every conflicted person recused himself or herself), and does not include transactions that the board reviewed but found not to involve any conflict of interest.

8) The queries about who prepared the financial statements, and about accountant services should be divided into two lines or parts.

The question about who prepared the financial statements should recognize another possibility:

The line about accountant services should be reconfigured to recognize more possible services, and to recognize that not all services require a CPA to be independent.

Indicate which of the following services the organization received concerning its financial statements for the year reported in this Form 990:

- audit • review • compilation • assembly • none of these

If the organization received more than one service, indicate the highest level of service (from the left with audit as the highest) received.

For an audit or review, was the CPA ...? • independent • not independent

{If a filer marks audit or review and also marks *not* independent, the IRS's system should generate a discrepancy letter that explains that a service by a CPA who is not independent cannot be an audit or a review and that requests the filer to change one of these responses. }

For a compilation or an assembly, was the CPA ...? • independent • not

independent

Without this or some change in the text of the inquiries, many organizations that had received a compilation would be unable truthfully to check that box because often a compilation is made by an accounting firm that is not independent of its client.

Further, the instruction should include the following:

Do *not* check the compilation box if the compilation does not include a signed report. Do not check the box for any of the four accounting service if the person responsible for the service was not licensed as a certified public accountant. Even if relevant State law does not prohibit an unlicensed person from providing a service concerning another person's financial statements, such an unlicensed service is not a compilation or assembly for the purposes of this inquiry.

10) The Service should rewrite this question:

Did the organization's • full governing body • committee of the governing body review this Form 990 before it was filed?

Definitions

In the text of the line-by-line instructions, don't include a definition that's lengthy or that's used repeatedly. Instead, **bold** the defined term and in the general instructions tell a reader to look to a glossary at end of booklet. In that glossary, include *every* definition, even those that were explained in the text of the line-by-line instructions. In the glossary, each term that is defined in the Internal Revenue Code or a regulation should be explained with a paraphrase of that rule and a citation to the statute or regulation.

Add the following reporting rule:

If a term isn't defined in the instructions booklet, a filer acts in good faith if it follows reasonably the meaning given by the current edition of a widely recognized dictionary.

Part X – Signature Block

“Signature of officer” should be replaced with “Signature of authorized person”. Among other possibilities, the exempt organization might not have any officer, and a signer might be a trustee.

Software developers

After considering comments, the Service might make another exposure draft for discussion with software developers. They might suggest useful ways to reduce the risks that a filer misunderstands a query. Further, a software developer might support internal-consistency checks that use “to” and “from” leads of the form’s and schedules’ queries to help a filer test for mathematical or logical impossibility or inconsistency. While the software developers would have their own business purposes, the Service could harness this to get some advantages in cleaner filings.

I’d be glad to discuss with those Service people working on this project any of my comments, and any further or other information that might be helpful to this Redesign.

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Subject: Comments on Proposed Revisions to Form 990
Date: Friday, September 14, 2007 5:02:16 PM
Attachments: [Draft Comments on Form 990 - Final.doc](#)

Attached please find comments submitted on behalf of the organizations listed below. We appreciate your consideration of our views.

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transaction or matter that is the subject of this communication.

VIA E-MAIL

September 14, 2007

Form 990 Redesign, ATTN: SE:T:EO
Internal Revenue service
1111 Constitution Ave., N.W.
Washington, DC 20224

Re: Draft Form 990

These comments are submitted on behalf of the organizations listed below, all providers of business and transactional legal services to nonprofit organizations in the cities and other locations in which these organizations maintain their offices ("the Providers"). These organizations provide corporate, real estate, employment and other business legal counsel to community-based nonprofit organizations that are working to alleviate poverty and otherwise improve the quality of life in their communities. The clients represented by these Providers are typically smaller, less-sophisticated nonprofit organizations, without resources with which to pay counsel. The legal services provided to them are most often delivered on a pro bono basis, using attorneys from law firms and corporations who volunteer their time and expertise.

Counsel offered by the Providers also includes representation in matters concerning regulation of tax-exempt organizations by the Internal Revenue Service, including applications for recognition of tax-exempt status and reporting using IRS Form 990. These comments are submitted with the concern that most users of Form 990 do not have access to counsel qualified to practice in this area, because they are located in an area without an active business law pro bono program to which to turn and they cannot afford to pay for counsel experienced in this area. Please consider the following to be offered from that perspective, rather than as a review of the many issues raised by the Draft 990 which do not implicate the concerns of smaller nonprofit filers of the form.

General Comments

1. Redesign of the Form 990 Structure

The most dramatic aspect of the draft form, its redesigned structure, is welcome. Specifically, the concept of stripping the "core form" of information that is not applicable to most filers, and moving those inquiries into separate schedules, both enhances the simplicity of the form and reduces the burdens of completing it.

However, the benefits of the new structure may be undercut if the triggers for requiring completion of schedules are defined too broadly or set at dollar thresholds that are too low. In particular (and as set forth below), the potentially wide applicability of

Schedule G (as it applies to special event fundraising) and Schedule I (depending upon the final definition of “grants and assistance,” and whether it includes noncash assistance) calls for careful consideration in order to preserve the benefits of the simplified new structure.

2. Non-enforcement Uses of the Redesigned Form

While Form 990 was originally designed for use in the enforcement of the tax laws, other uses have evolved over the decades since it was first released. An increasing number of stakeholders with other interests in the information that is or could be provided therein continue to clamor for more and different questions, for purposes as disparate as enforcement of state charities laws, academic research, and donor assessments about the efficiency of filing organizations.

In accommodating those stakeholders, the IRS must be acutely sensitive to the reality that it is catering to audiences with wildly varying degrees of sophistication who are untrained or casual in its use and who may misinterpret the significance of information found in a completed form 990. Putting aside the debate about the fundamental value of efficiency ratios of the kind that are included on page one of the draft form, any information presented in that format must be presented in an unmistakable manner, or much inadvertent damage can be done to filers through the dissemination of misinterpretations of the information compared therein.

3. Dollar Thresholds

Obviously, the burdens of compliance for many small organizations could be alleviated if the number of those required to file were reduced. The dollar thresholds could be raised to \$50,000 on the 990N and \$100,000 or even \$200,000 on the 990. Organizations with less than the new threshold but more than \$50,000 in income could file the 990EZ.

Our justification for this change is threefold:

1. Smaller nonprofits are a much smaller risk from a compliance viewpoint; the amounts at risk do not justify the allocation of enforcement resources.
2. The cost of compliance at the current thresholds will be too high. A nonprofit with less than a \$100,000 – 200,000 budget rarely has a trained financial person on staff. They may not have an audit, only a review of their financial statements by a CPA. To prepare the new 990 they will have to hire a trained finance person, purchase more sophisticated accounting software and, as a result, spend funds for salary, benefits and equipment in order to comply. Small nonprofits will struggle with compliance and the information that they provide may not be very reliable or particularly meaningful information for the IRS or the public.

3. The new form will likely impact volunteer board recruitment. To ask someone to assume these burdens in order to serve on the board of the local school mentoring program, for example, may discourage that service. Small nonprofits already have difficulty recruiting Board members, and more sophisticated candidates, who understand the disclosure requirements and the greater risks of serving on a Board, may gravitate toward organizations with the resources to access professional help.

Part I

- **Question 8b**, which creates a ratio of director/officer/key employee compensation to total program service expenses, will likely lead to calculations that unfairly depict small nonprofits. For smaller nonprofits, labor costs are by far the largest expense, and (given the tax code's definition of "key employee"), a large percentage of a small nonprofit's staff are often classified as key employees. Therefore, small nonprofits will always have a large percentage in 8b, making them appear inefficient. Using the current dollar threshold for "highly compensated employees" rather than the broader definition of "key employee" would mitigate this problem, but not eliminate it. Larger organizations will always appear to be more efficient, even when that is not actually the case.
- **Question 26 and Schedule G**, concerning fundraising efficiency ratios, present multiple problems for smaller, less established organizations, and also contain presentation defects that will afflict even large nonprofits that raise funds through special events or other activities involving outside fundraising professionals.

Question 26, line (iii) and (iv) present information about fundraising efficiency that is false, or at least highly misleading, in that it *overstates* fundraising efficiency. Only the costs of professional fees are required to be listed among the "expenses" on line 26(ii), and not the staff time and other "in house" expenses paid directly by an exempt organization that are associated with mail, e-mail, telephone, and other fundraising campaigns in which an outside professional may also play a role. This ratio is apparently designed with a "turn key" professional fundraising service in mind, one in which the outside professional assumes responsibility for payment of all expenses associated with the fundraising campaign and passes those costs along to the nonprofit client. That model, however, represents the minority of most fundraising campaigns today. Much, much more common are "fundraising consultant" arrangements in which a fee for guidance is charged by the fundraising professional, but all expenses in implementing that guidance are paid directly by the exempt organization.

By contrast, the presentation of event fundraising in Schedule G is false, or at least highly misleading, in that it *understates* fundraising efficiency in that form of fundraising. By excluding "charitable contributions" from the definition of "gross revenue," an irrational implication is created that deductible charitable contributions are somehow not available for the exempt organization's charitable

programs. While there may be reasons to separate out revenues that are deductible to the donors from payments received by a charity in special event fundraising that are not deductible, fundraising efficiency can only be assessed by comparing *total* revenues to expenses. This problem is not new -- it is the source of much mischief in the current 990, leading to erroneous news reports and much donor confusion – but that erroneous picture is repeated here in the way that “net income” is calculated.

The focus on third party fundraising will also penalize nonprofits that are new and must build up name recognition and donor lists through direct marketing. By requiring an event-by-event accounting, Section II of Schedule G ignores the fact that nonprofits sometimes engage in money losing or break-even special events for reasons beyond fundraising. Many such events are designed to raise awareness of the organization’s mission, a common objective if advocacy is an important part of its mission, and are used for building donor lists, increasing name recognition and donor cultivation (i.e., "friendraisers"). By pressuring nonprofits into turning a profit with every fundraising event, this presentation in the form places a premium on short term results and not long term planning, and favors larger, more established nonprofits

By contrast, **Questions 17-21** are much more relevant because they track overall fundraising expenses versus income, and not event-by-event. They help provide guidance to a potential donor regarding the use of future donations to the organization. However, these questions would be more meaningful if the IRS used a five year average, analogous to measuring whether a nonprofit has sufficient public support to be classified as a public charity, because the form would then even the playing field between newer and older organizations, and would give organizations more flexibility in balancing the needs of awareness raising, donor cultivation and pure fundraising. It would also be more consistent with the public support test, with which, from a policy perspective, it should dovetail.

Part II - Section A

- It is unclear what it means to "manage a discrete segment that is material to the organization."
- With respect to former employees, column C needs to be clarified to explain whether it is meant to refer to the employee’s position during their last year or employment in the highest position they held within the organization.
- The definition of "key employee" in the glossary is difficult to locate and may be overlooked, inasmuch as it is listed under "employee, key."

Part II – Section B

- **Question 5, part (b)** should exclude relationships between directors on the same board that do not in any way involve transactions with or the interests of the exempt organization.
- **Question 5, parts (e) and (f)** are overly broad. Even with the aggregate \$5,000 threshold that applies to "business relationship," much useless information will be captured. For example, what if the CEO of Office Depot is on your board? Do you keep track of every paper purchase? An aggregate threshold of \$25,000 or more would be more realistic.
- **Question 5(f), Column (v)** – Is this meant to apply to the organization doing the 990 reporting, and/or some other entity?
- **Question 9** – This question seems to include scenarios in which volunteers are paid by other sources to enable them to provide their services to an exempt organization, without any other benefit to those outside sources. Is that type of in-kind contribution intended to be captured here?

Part III

- **Question 3** creates the impression, like other questions in this section, that conflict of interest policies are somehow a requirement of the tax code. Additionally, question 3b might have the opposite effect as that which is apparently intended. If its involvement in matters of governance of this kind is warranted at all, the IRS should encourage organizations to use conflict of interest policies which they have adopted, and this question might make groups perceive that reporting a higher number of such instances will operate to their disadvantage.
- **Questions 4-5** reference policies that are not mandatory, and in the case of a whistleblower policy, probably not necessary for a small nonprofit. Moreover, the existence of such policies has no bearing on the quality of the policies or whether they are being applied in instances in which they should be.
- **Question 7** seems to belong more appropriately on the annual group exemption report. If the chapters have separate 501(c)(3) status, why is it relevant? It is also not clear whether the IRS is concerned about group exemptions or group returns.
- **Question 9** is unrealistic for a small nonprofit with a Board who already has trouble mustering participation in Board activities. To recruit Board members to serve on an audit committee *and* also to maintain a separate finance committee seems a burden, and an unnecessary one for small nonprofits.

- **Question 10** – What does it mean for the governing body to “review” the 990? Does this mean merely to read the information contained therein? Understand that information? Vouch for its accuracy? The scope of this question is unclear, and that lack of clarity may create unintended disincentives to Board service by those who are uncertain about the burden that they would be assuming.
- **Question 11** – Since 990 and 990-T are the only ones that have to be reported, why are the rest listed?

Part V

- Many of these questions are repetitive, and ask for disclosure of information already provided elsewhere. This examination of expense allocations goes far further than the simpler version included in the current Form 990, reportedly included at the behest of state regulators. This should be just a statement of expenses that serves those interests in a simpler format.

Part IX

- **Question 2** – This question seems too broad and doesn’t seem to have a clear purpose. How is an organization to identify its most significant program service accomplishment for the year? What is the purpose of this question?

Schedule G

- What constitutes a “business relationship”? (The instructions have examples, but it is still unclear.)

Schedule I – Part II

- **Part I.** A lot of organizations have constituent boards, and CHDOs and federally qualified health centers are required to have up to 51% of their boards composed of representatives of the populations that they serve. The form should ask the nonprofit to make that clear.
- **Part II.** \$5,000 is too low a threshold, especially with the recordkeeping of in-kind and cash. For groups that distribute in-kind materials, the valuation is going to be difficult. For example, food banks that distribute food to shelters will have a difficult time with valuation. How are they to value the food they distribute?
- **Part III.** In the instructions to the Core 990, Part V, the grants to individuals seems to be limited to research grants, stipends and scholarships. However, the instructions to **Schedule I** clearly want more information than that. In addition, the recordkeeping requirements here will be difficult. For example, legal aid organizations will have to keep time sheets, as will other social service providers,

to break out the cash versus non-cash amounts. With non-cash benefits included, this will pick up many more organizations than the intended and add a lot of expense for small organizations.

Schedule L

- **Schedule L. Part II.** I appreciate the concern about loans to executives, but note that it is rather common for directors to make no-interest or low interest loans to their organizations. The disclosure, and the loss of privacy, could significantly inhibit this activity. Even though there is nothing wrong with a zero interest loan to the organization, a director/donor may not want the general public to know that he or she loaned, say \$100,000 to the nonprofit. At the very least **Part II** should not be open to public inspection.

Schedule N

- The Schedule references Part I, Line 11, but the correct reference is Line 10.

Please do not hesitate to contact the undersigned if you have any questions.

Respectfully submitted,

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