



Section of Taxation

10th Floor
740 15th Street, N.W.
Washington, DC 20005-1022
202-662-8670
FAX: 202-662-8682
E-mail: tax@abanet.org

September 28, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Form 990-PF and Related Instructions

Dear Commissioner Shulman:

Enclosed are comments on Form 990-PF and related instructions. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles H. Egerton".

Charles H. Egerton
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
Ruth Madrigal, Attorney-Advisor, Office of Tax Policy, Department of the Treasury
Catherine E. Livingston, Assistant Chief Counsel (Employment Tax/Exempt Organizations/Government Entities), Internal Revenue Service
Lois G. Lerner, Director, Exempt Organizations Division, Internal Revenue Service

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ABA SECTION OF TAXATION COMMENTS ON FORM 990-PF AND RELATED INSTRUCTIONS

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

Principal responsibility for preparing these Comments was exercised by Victoria B. Bjorklund of the Committee on Exempt Organizations of the Section of Taxation. Substantive contributions were made by Betsy Buchalter Adler, Eve Borenstein, Susannah Camic, Thomas E. Chomicz, Jillian P. Diamant, Barbara Rosen, Tammy Watts, and Brian Yacker. The Comments were reviewed by Frederick J. Gerhart, Committee Chair. The Comments were further reviewed by Carolyn Osteen of the Section’s Committee on Government Submissions and by Michael A. Clark, Council Director, for the Exempt Organizations Committee.

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

Contact Person:

Victoria B. Bjorklund
(212) 455-2000
vbjorklund@stblaw.com

Date: September 28, 2010

EXECUTIVE SUMMARY

On September 4, 2009, the Internal Revenue Service (the “Service”) issued a request for comments¹ on Form 990-PF, Return of Private Foundation (“Form 990-PF”), and its instructions (the “Instructions”). More specifically, the Service requested comments on (1) whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the agency’s estimate of the burden of the collection of information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; (4) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (5) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

These Comments address the issues specifically raised in the request for comments and focus on the third and fourth requests in an effort to maximize usefulness of the information collected both to the Service and to the private foundation sector. The Comments consider the benefits of increased disclosure on Form 990-PF, as well as the burdens imposed on private foundations. In general, we believe that the Instructions for the Form 990-PF should be revised to increase clarity for the reporting foundations and to enhance accountability to the Service and transparency to the public. We do not believe that revising the Form 990-PF would be valuable at this time, given the limited resources of the Service and the Service’s expressed preference for taking a “wait and see” approach before redesigning the Form 990-PF.² Therefore, these Comments recommend changes only to the Instructions and not to the Form 990-PF.

¹ Comment Request for Forms 990-PF and 4720, 74 Fed. Reg. 45,902 (Sept. 4, 2009).

² The Service has indicated that it believes it is appropriate to take a “wait and see” approach to redesigning the Form 990-PF to evaluate the redesigned Form 990, Return of Organization Exempt from Income Tax, which the Service revised for use starting in the 2008 tax year (“Revised Form 990”). See Service’s response to the 2008 recommendations made by the Taxpayer Advocacy Panel, *available at* <http://www.improveirs.org/annualreports/2008%20Recommendations%208-5-2009.pdf>.

Introduction

These Comments propose changes to the Instructions of the Form 990-PF and follow the order in the Instructions.

Comments on Form 990-PF Instructions

1. ***Part I—Analysis of Revenue and Expenses – Expense Allocations.***

The Instructions state that a foundation may use “any reasonable methodology” for allocating expenses in Part I. We believe this is insufficient direction for foundations lacking professional guidance. We suggest clarifying the meaning of “any reasonable methodology” and adding an explicit statement in the Instructions that the sum of column (b), “Net investment income,” and column (d), “Disbursements for charitable purposes (cash basis only),” is not required to equal the amount in column (a), “Revenue and expenses per books.” Additionally, we suggest that the Instructions address the Part I allocation of expenses that are neither investment nor grantmaking expenses, and as such, are not appropriately reported in column (b) or column (d) of Part I.

2. ***Part I—Analysis of Revenue and Expenses – Differences Between Columns (a) and (d).***

We understand that many foundations believe that the current format of Part I indicates that anything that is not a grant is overhead. Therefore, some foundations include direct program expenditures in line 25, “Contributions, gifts, grants paid,” even though the Instructions provide that line 25 should include only gifts and grants. Also, since column (d) is reported on the cash basis and not based on books and records, which often are kept on the accrual basis, some foundations find this practice leads to reader misunderstandings. We suggest including examples in the Part I Instructions that highlight situations in which amounts reported in column (a) may differ from column (d), such as, for example, when legal fees have been accrued by a foundation.

3. ***Part I—Analysis of Revenue and Expenses – Reporting of Gains and Losses and Information Return Issues.***

We suggest that the Part I Instructions provide that the revenue amounts reported in column (a) should not include unrealized gains and losses. Additionally, we believe the Instructions should more explicitly state that in many instances the capital gains reported on line 6, “Net gain or (loss) from sale of assets not on line 10,” of column (a) will not be the same as the capital gains reported on line 7 of column (b). This is the case, for example, when securities have been marked to market or when donated securities have been sold by the foundation. Finally, we suggest that the Instructions provide guidance regarding the completion of Part I for fiscal-year private foundations who receive Schedules K-1 (Forms 1065), Partner’s Share of Income, Credits, Deductions, and Other Items, and Forms 1099 based on a calendar year.

4. ***Part I, Column (c)—Analysis of Revenue and Expenses, Adjusted Net Income.***

Part I, column (c), “Adjusted net income,” is apparently intended for private operating foundations described in section 4942(j)(3) and (5),³ because the calculation of “adjusted net income” is necessary for private operating foundations but not for private non-operating foundations. However, many private non-operating foundations are not aware that they do not need to fill out that column. The Instructions for that column are confusing in that they also require private non-operating foundations that have “income from charitable activities” that is either “gross sales” or “other” to complete lines 10, “Gross sales,” and 11, “Other income” of that column, and report expenses related to earning that income. The latter requirement serves an extremely limited purpose. We suggest indicating in the Instructions that column (c) is only for organizations recognized by the Service as private operating foundations. We also suggest either removing the requirement that private non-operating foundations that have “income from charitable activities” that is either “gross sales” or “other” complete lines 10 and 11 or requiring that reporting in another part of the Form 990-PF.

5. ***Part I, Column (c)—Analysis of Revenue and Expenses, Adjusted Net Income; Part IX-A—Summary of Direct Charitable Activities; Part XIV—Private Operating Foundations; Part XVI—Analysis of Income-Producing Activities.***

The private operating foundation sections of the Form 990-PF (*i.e.*, Part I, column (c), Part IX-A, Part XIV, and Part XVI, in part) are not grouped together. We believe there is a lack of understanding regarding which portions of the Form 990-PF a private non-operating foundation should complete and which portions a private operating foundation should complete. We suggest clarifying the Instructions to distinguish more clearly the filing obligations of private operating foundations from the reporting obligations of private non-operating foundations.

6. ***Part II—Balance Sheets – Use of Fair Market Value.***

We believe that the Instructions should clarify that for private foundations that follow Financial Accounting Standards Board rules that require recognition of unrealized gains and losses on investments for financial statement purposes, the “Book value” amounts in columns (a) and (b) of Part II should be fair market values. Currently, some foundations use fair market value in these columns and some use original cost basis. Original cost basis must be tracked in the foundation’s books and records, but cost-basis amounts should not be used in the current Form 990-PF if “book value” means financial statement value. We suggest that the Instructions state that amounts in columns (a) and (b) should be fair market values if fair market values are reported in the foundation’s financial statements.

7. ***Part II—Balance Sheets – Supporting Schedules.***

We suggest that the Instructions be revised to provide that a private foundation is not required to attach detailed schedules or statements to the Form 990-PF listing each and every security in which the private foundation has invested.

³ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

8. ***Part VII-B, Line 3—Statements Regarding Activities for Which Form 4720 May Be Required.***

The Instructions regarding the reporting of excess business holdings are confusing. We understand that foundations often believe that exceptions to the excess business holdings rules apply when they do not. We suggest that the Instructions be revised to more clearly set forth the applicable law and to provide private foundations with guidance regarding when they might have a potential excess business holdings issue. For example, the Instructions could be modified to add direction for line 3b (which currently does not have specific instructions) defining “excess business holdings” as the amount of stock or other interest in a business enterprise held by the foundation that exceeds the permitted holdings, and indicating that a private foundation is generally permitted to hold up to 20% of the voting stock of a corporation, reduced by the percentage of voting stock owned by disqualified persons. This change would conform with the language on the Service’s website regarding excess business holdings.

9. ***Part X, Line 1c—Minimum Investment Return, Fair Market Value of All Other Assets.***

We suggest that the Instructions to Part X, line 1c, be revised to state that assets other than cash and securities also must be valued. Many private foundation returns do not include the values for real estate, antiquities, and similar assets on Part X, line 1c. Additionally, we suggest that the Instructions provide additional guidance on the valuation rules for real property.

10. ***Part XII, Line 3b—Qualifying Distributions, Cash Distribution Test.***

Amounts set aside for specific charitable purposes that satisfy the cash distribution test are reported on Part XII, line 3b, as qualifying distributions. The Instructions require a foundation to attach a schedule to the return showing how the cash distribution requirements are met. A schedule is required for each year of the set aside and for each subsequent year until the set aside amount has been distributed, as provided in Regulation section 53.4942(a)-3(b)(7)(ii).

We suggest modifying the Instructions to require the foundation to provide a separate schedule to the Form 990-PF setting forth the information necessary to satisfy all of the requirements of the cash distribution test in a manner similar to the separate schedules that are provided as part of the Revised Form 990, which has a core form and additional reporting schedules.

11. ***Part XII, Line 4—Qualifying Distributions.***

Foundations may make charitable grants to other private foundations or to controlled public charities that the grantor foundation does not intend to count as qualifying distributions. The current Instructions to Part XII do not provide any straightforward way for a grantor foundation to subtract such amounts in computing its qualifying distributions for the current year. When completing Part XII, the grantor foundation may mistakenly report all charitable grants as qualifying distributions, and will therefore overstate its qualifying distributions. We suggest that the Instructions for Part XII, line 4, be revised to provide that, if the grantor private foundation does not plan to treat an amount distributed to another private foundation or to a controlled public charity as a qualifying distribution under section 4942(g)(3), then the grantor private foundation should reduce the amount on line 4 and attach a schedule showing the reduction amount, and explaining that this amount is not being treated as a qualifying

distribution and that the foundation has sufficient other qualifying distributions to meet its section 4942 requirements.

12. Part XIII, Line 4c—Undistributed Income, Treated as Distributions Out of Corpus.

Very few private foundations understand the mechanics for making the election in Part XIII, line 4c, and when it is beneficial for them to do so. We suggest that the Service clarify the Instructions for the Part XIII, line 4c, election to set forth the advantages of making that election and to provide a sample election statement.

13. Part XV, Line 3—Supplementary Information, Foundation Status.

The Instructions do not explain how to complete the column titled “Foundation status of recipient.” As a result, many preparers either leave this column blank, or enter “501(c)(3),” which does not address recipient status under section 509. We believe that the purpose of this column is to determine whether the grantor foundation needed to perform expenditure responsibility for the grant. Therefore, we suggest that the Instructions for Part XV be revised to require the grantor foundation to complete the column titled “Foundation status of recipient” by entering “NC” for a recipient non-charity, “PF” for a recipient private non-operating foundation, “POF” for a recipient private operating foundation, “EOF” for a recipient exempt operating foundation under section 4940(d)(2), and “PC” for a recipient public charity. If the recipient is a section 509(a)(3) supporting organization, we suggest the grantor foundation be directed to report in the “Foundation status of recipient” column the type of supporting organization by entering “SO I” if it is a type I supporting organization, “SO II” if it is a type II supporting organization, “SO III FI” if it is a functionally integrated type III supporting organization, or “SO III NFI” if it is a non-functionally integrated type III supporting organization, as those terms are used in section 4942(g)(4). We further recommend that the Instructions be revised to direct preparers to Notice 2006-109⁴ and Revenue Procedure 2009-32⁵ for guidance on determining whether a grantee is a type I, type II, functionally integrated type III, or non-functionally integrated type III supporting organization.

If the purpose of the “Foundation status of recipient” column in Part XV, line 3, is not to identify whether the grantor foundation needed to perform expenditure responsibility, then we suggest that the Instructions be revised to reflect the purposes of this column. If there is no express purpose for this column, we suggest that it be deleted. The “Foundation status of recipient” column in Part XV, line 3, may be unnecessary given the partial overlap with information requested in Part VII-B, line 4; with respect to investments that jeopardize a foundation’s charitable purpose. We note, however, that Part VII-B, line 4, has not been updated to address the need to perform expenditure responsibility on grants given to non-functionally integrated type III supporting organizations. Since we understand that the Service does not wish to revise the Form 990-PF at this time, we suggest revising the Instructions for Part XV, line 3, instead.

⁴ 2006-2 C.B. 1121.

⁵ 2009-28 I.R.B. 142.

14. ***Part XV, Line 3b—Supplementary Information, Approved for Future Payment.***

We suggest that the Service clarify the Instructions for Part XV, line 3b, with respect to grants approved for future payment to specify the information the Service is seeking. The Instructions are not clear as to whether to list grants approved during the filing year that have not yet been paid or multi-year grants that were approved in prior years but have not been completely paid. We recommend that the Instructions for line 3b require that each approved grant that has not been paid by year end be listed, regardless of whether such grant was approved in the current year or in a prior year.

15. ***Additional General Comments on Instructions***

a. ***Start-up Period Minimum Amount***

The Instructions do not address where a new private foundation is to reflect the calculation of its reduced “start-up period minimum amount” pursuant to Regulation section 53.4942(a)-3(b)(4)(ii). As a result, it is unclear whether the foundation is permitted to take each of the four years’ reduced amounts (to achieve the 20%, 40%, 60%, and 80% annual distribution amounts that need be paid out in the aggregate no later than the end of the foundation’s “start-up period”) as set-asides on Part XII, line 3b, or as a reduction against the calculation of its distributable amount on line 6 in Part XI. In addition, if a preparer forces an entry on either of those Parts (or alternatively, inputs a faux offset on Part XIII) to avoid having undistributed income on Part XIII with concomitant excise tax liability, there is no enunciation of how the foundation should confirm that its minimum pay-out requirement has been met because private foundations are allowed to make the start-up period minimum amount distributions at any time during the start-up period, not in any particular tax year.

b. ***60-month Terminations***

Under Temporary Regulation section 1.507-2T(e)(1),⁶ a private foundation that gives notice of its intention to operate as a public charity and satisfies all of the requirements under section 507(b)(1)(B) during the continuous 60-month period will be treated in the same manner as a public charity for the entire 60-month period. Temporary Regulation section 1.507-2T(e)(2)(ii) provides that sections 507 through 509 and chapter 42 shall not apply to such organization for any taxable year within such 60-month period for which it meets the requirements of section 509(a)(1), (2), or (3). However, an organization that is in its 60-month termination period is still required to file the Form 990-PF, not the Form 990, for all but the final taxable year of the 60-month period. We suggest that the Instructions for the Form 990-PF be revised to include directions for an organization in its 60-month termination period as to how and where to indicate this fact on the return, such as by requiring the words “In 60-month termination period” at the top of the first page. In addition we suggest that the Instructions clarify that private foundations terminating their status as such do not need to complete Part VII-B regarding activities for which Form 4720 may be required.

⁶ 73 Fed. Reg. 52,218 (2008).

c. Supporting Schedules

It would be helpful to have the flexibility to add supporting schedules that would allow an organization to provide additional context when the Form 990-PF is e-filed. It would be helpful if the Instructions addressed how best to provide additional information.