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

Re: Comments Concerning the Instructions for the Redesigned Form 990 for Tax-Exempt Organizations

Dear Commissioner Shulman:

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

Sincerely,

Stanley L. Blend
Chair, Section of Taxation

Andrew J. Demetriou
Chair, Health Law Section

Enclosures

cc: Hon. Donald L. Korb, Chief Counsel, Internal Revenue Service
Hon. Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
Karen Gilbreath Sowell, Deputy Assistant Secretary (Tax Policy)
Eric San Juan, Deputy Tax Legislative Counsel, Department of the Treasury
Emily Lam, Attorney Advisor, Office of Tax Policy, Department of the Treasury
Catherine Hughes, Attorney-Advisor, Office of Tax Policy, Department of the Treasury
Steve Miller, Commissioner, Tax Exempt & Government Entities Division, Internal Revenue Service
Lois Lerner, Director, Exempt Organizations, Internal Revenue Service
Robert Choi, Director, Exempt Organizations Rulings and Agreements, Internal Revenue Service
Catherine Livingston, Assistant Chief Counsel, Tax Exempt/Government Entities, Internal Revenue Service
Ronald Schultz, Senior Technical Advisor to the Commissioner, Internal Revenue Service
Revenue Service

**AMERICAN BAR ASSOCIATION
SECTION OF TAXATION AND HEALTH LAW SECTION COMMENTS
CONCERNING THE INSTRUCTIONS FOR THE REDESIGNED FORM
990 FOR TAX-EXEMPT ORGANIZATIONS**

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

Principal responsibility for preparing these Comments was exercised by Michael A. Clark, Chair of the Section of Taxation’s Exempt Organizations Committee and a Vice-Chair of the Health Law Section’s Tax and Accounting Interest Group. Substantive contributions were made by Michael G. Bailey, Victoria B. Bjorklund, Boyd J. Black, Eve Borenstein, Bonnie S. Brier, Bernadette M. Broccolo, Thomas E. Chomicz, Ralph E. DeJong, David M. Flynn, Robert W. Friz, Laura Gabrysch, Gerald M. Griffith, Karen A. Hayes, Edward H. Hein, James Joseph, Elizabeth Kingsley, Nancy Ortmeyer Kuhn, Lauren K. Mack, Elizabeth M. Mills, Richard L. Sevcik, Jack B. Siegel, Gwen Spencer, and Brian D. Yacker, who are members of the Section of Taxation’s Exempt Organizations Committee or the Health Law Section’s Tax and Accounting Interest Group. The Comments were reviewed by Douglas M. Mancino of the Section of Taxation’s Committee on Government Submissions; Richard S. Gallagher, Council Director for the Section of Taxation’s Exempt Organizations Committee; and Frederick J. Gerhart, Co-Chair of the Health Law Section’s Committee on Government Submissions and Policy.

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

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Date: July 16, 2008

EXECUTIVE SUMMARY

On April 8, 2008, the Internal Revenue Service (the “Service”) released for public comment the instructions for the redesigned Form 990 (the “Instructions”), the annual information return for tax-exempt organizations required under section 6033.¹ The redesigned Form 990, which was released December 20, 2007,² includes a “Core Form” with Parts I through XI, to be completed by all exempt organizations not eligible to file Form 990-EZ, and 16 new Schedules, which will be completed depending upon the activities of the filing organization. These Comments respond to the Service’s request for comments on the draft Instructions.³

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

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

The Instructions continue the Service’s commendable progress toward the first two goals, as well as achieving much needed simplification in some areas, most notably in the elimination of the filing of Form 8734 by newly created organizations.⁴ In addition, the phase-in period for use of the new Form 990, and the increased thresholds for filing the Form 990-EZ, are helpful in limiting the burden of the new Form 990 on smaller organizations. We continue, however, to believe that a permanent increase in the filing threshold for filing the Form 990 or Form 990-EZ should be considered.⁵

¹ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated, and references to Regulations are to the Treasury Regulations promulgated thereunder.

² IR-News Re. 2007-204, available on the Service’s web site at <http://www.irs.gov/newsroom/article/0,,id=176722,00.html>.

³ IR-News Rel. 2008-60, available on the Service’s web site at <http://www.irs.gov/newsroom/article/0,,id=181460,00.html>.

⁴ Prior comments submitted by the Section of Taxation also suggested the elimination of the requirement of filing Form 8734 by organizations that have obtained an advance ruling that they are likely to meet the “public support” tests under sections 170(b)(1)(A)(vi) or 509(a)(2). Comments Pursuant to Internal Revenue Service Announcement 2002-92, 2002-41 I.R.B. 709 on Proposed Revisions to IRS Form 1023 and Instructions, available at <http://www.abanet.org/tax/pubpolicy/2002/021202eo.pdf>.

⁵ See Report of National Taxpayer Advocate, Annual Report to Congress 427-28 (2006), available at http://www.irs.gov/pub/irs-utl/2006_arc_section2_v2.pdf. As noted by the National Taxpayer Advocate, the filing threshold has not been adjusted for inflation for approximately 25 years. The National Taxpayer Advocate recommends increasing the filing threshold to \$50,000 from its current level of \$25,000.

These Comments contain a number of specific suggestions for the improvement of the Instructions. Our Comments include the following suggestions:

1. Modify the Instructions to the Core Form to provide guidance to newly created organizations in the use of the Form 990 prior to the organization's receipt of an exemption determination from the Service.
2. Simplify the Core Form Part VI disclosure of family and business relationships among officers, directors, and trustees, and the Schedule L disclosure of business transactions between such individuals (and related parties) and the organization.
3. Refine the definitions of "officers" and "key employees" for purposes of Part VII of the Core Form, as applied to large exempt organizations, to limit reporting to individuals with some meaningful opportunity to control significant actions by the organization.
4. Revise the Schedule C reporting of lobbying activities to eliminate the requirement for organizations to determine whether their lobbying activities are "substantial."
5. Clarify the reporting of endowment funds on Schedule D and Part IX of the Core Form for organizations operating in states which have adopted legislation permitting current spending of some portion of such funds by organizations.
6. Permit foreign organizations operating in the United States to complete Schedule F only with respect to their activities funded with income from sources within the United States.
7. Include in hospital "other community benefits at cost" on Schedule H the costs of continuing medical education and nursing education, provided that the educational programs are offered pursuant to a community needs assessment and the individuals participating in the educational programs are not precluded by non-competition or other agreements from performing services for other health care providers.
8. Provide additional guidance in the Schedule K Instructions for reporting of tax-exempt financings for "obligated groups" and "composite bond issues."
9. Eliminate the Schedule L reporting of "grants or assistance" to individuals related to the organization's officers, directors, and key employees if the grants and other assistance are provided through an objective process in furtherance of the organization's exempt purposes.
10. Limit the application of Schedule N to the reporting of transactions which result in a significant permanent reduction of the net assets of the organization, rather than routine asset sales or grants.

11. Avoid duplicate reporting of grants to related exempt organizations by either eliminating the reporting of such grants on Schedule I or permitting reporting of such grants on Schedule R by a cross-reference to Schedule I.

SPECIFIC COMMENTS ON INSTRUCTIONS

I. COMMENTS ON CORE FORM INSTRUCTIONS

A. Highlights and General Instructions

1. *Who Must File (Pages 6-8)*

a. Organizations claiming exemption prior to filing Form 1023 or 1024

Because newly created organizations claiming section 501(c)(3) status have up to 27 months to file Form 1023, it is not uncommon for such organizations to complete one or more accounting periods prior to their receipt of recognition of exemption. Similarly, non-section 501(c)(3) organizations which are not subject to the time limitations specified by section 505(c) may also wait some time before filing Form 1024⁶ or a letter application.⁷ Although these organizations often will not have sufficient gross receipts to require the filing of a Form 990 or Form 990-EZ, in some instances the gross receipts of the organization will be sufficient to trigger a filing requirement.

It would be useful for the Instructions to address the filing requirements of such organizations. The Form 990 would seem to be the most appropriate form for such organizations to file if they are likely to qualify for exemption, and we suggest that the Instructions so provide.⁸

b. Certain religious organizations

On page 8, the Instructions describe certain supporting organizations described in section 509(a)(3) which are not required to file returns because of their relationship with a church or certain other religious organizations. The first numbered item indicates that such organizations need not file if their gross receipts are normally \$25,000 or less and they qualify as “an integrated auxiliary of a church.”

Under section 6033,⁹ an organization can qualify as an integrated auxiliary of either a church *or* a “convention or association of churches.” Thus, we suggest that the first numbered

⁶ A Form 1024 is filed by organizations seeking recognition of exemption as organizations described in sections 501(c)(2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19), and (25).

⁷ Organizations seeking Service recognition that they are described in sections 501(c)(11), (14), (16), (18), (21), (22), (23), (26), and (27) apply for such status by letter to the Service.

⁸ See Reg. § 1.6033-2(c) (organizations claiming exempt status which have not yet established such status should file a return in accordance with the relevant instructions thereto and should state that such return is being filed in the belief that the organization is exempt under section 501(a), even though its exempt status has not yet been established).

⁹ Reg. § 1.6033-2(h)(1)(ii).

item under the discussion of section 509(a)(3) supporting organizations in the Instructions be revised to cover “an integrated auxiliary of a church or a convention or association of churches.”

2. *Organizations Not Required to File Form 990 (Pages 8-10)*

a. Certain religious organizations

On page 9, the Instructions list the religious organizations which are not required to file Form 990. The first item listed makes the same omission noted above, failing to acknowledge that a religious organization can be exempt from filing returns as an integrated auxiliary of *either* a church or a convention or association of churches. Therefore we suggest that, in order to conform to the Regulations, the first item be restated to include “a church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church *or convention or association of churches, including* a men’s or women’s organization, religious school, mission society, or youth group.” (added language in *italic*).

Also on page 9, the Instructions provide that a “school below college level affiliated with a church or operated by a religious order” is not required to file Form 990. While we appreciate the efforts of the Instructions to translate complicated tax rules into plain language, we are concerned that this provision is oversimplified and is likely to be misleading.

The Regulations contemplate a considerably more involved inquiry into the actual academic program of the school and its affiliation with a church or convention or association of churches.¹⁰ Thus, in order to be absolved from filing Form 990, a church-affiliated school must meet all the requirements for qualification as a “school” under section 170(b)(1)(A)(ii) *and* show that it is “affiliated” with a church or convention or association of churches under three alternative tests (the third of which requires an analysis of six factors).¹¹ We suggest that the Instructions thus refer to the relevant Regulations;¹² alternatively, the Instructions could attempt to summarize the provisions of the Regulations. Including the present language without elaboration, however, is likely to lead some organizations to conclude in error that they are not required to file Form 990, and thereby face potential penalties for failure to file a return.

b. Private foundations in fifth year of termination period.

The Instructions indicate that private foundations that are terminating their private foundation status by becoming a publicly supported organization should file Form 990-PF, rather than Form 990. We believe that Form 990 is the most appropriate form for such organizations, at least in the final year of the termination period, and that the Instructions should so indicate.

The current administrative practice of the Service for private foundations terminating their foundation status under section 507(b)(1)(B) has been that they continue to file a Form 990-

¹⁰ Reg. § 1.6033-2(g)(1)(vii).

¹¹ Reg. § 1.6033-2(h)(2), (3).

¹² Reg. § 1.6033-2(g)(1)(vii).

PF for the first four years of the 60-month termination period, and file Form 990 in the fifth and final year of the termination period.¹³ It is appropriate for such organizations to use Form 990 for the fifth and final year of the termination period if indeed they do meet the public support test, as can be determined if such organizations complete Schedule A. There is no public support schedule in the Form 990-PF. We believe that the Instructions should state that Form 990 and Schedule A are mandated for the fifth (and presumably final) year of the 60-month termination period.

In addition, as a result of the elimination of Form 8734 in favor of the new Schedule A, the 60-month termination process could also be simplified. The Regulations currently require that successful completion of the 60-month termination period be established by the filing of information evidencing that the organization qualifies as a public charity under sections 509(a)(1), (2), or (3) within 90 days of the close of the 60-month period.¹⁴ If private foundations terminating their status as such were required to file Form 990 and the new Schedule A to establish compliance with the 60-month termination requirements, the Service could simplify the Regulations to permit satisfaction of the requirement by a timely filed Form 990 and Schedule A for the fifth year of the 60-month termination period.

3. *Sequencing List (Page 10)*

The sequencing list is a helpful tool to explain to filing organizations the most advantageous order for the completion of the various parts and schedules of the Form 990. However, the list currently suggests that the balance sheet, Part X of the Core Form, should be completed as part of the third step for completion of the return.

Lines 5 and 6 of Part X of the Core Form require information from Schedule L, which details transactions with interested persons. We suggest that the Service consider moving the completion of the balance sheet (Part X of the Core Form) to some point in the sequencing list after the completion of Schedule L, such as the seventh step in the sequencing list.

4. *Accounting Periods and Methods*

The “TIP” on page 10 of the Instructions suggests that exempt organizations consult IRS Publication 538, Accounting Methods and Periods, for additional guidance. However, the most recent revision of Publication 538 (March 2008) appears to contain no guidance with respect to exempt organization changes of accounting periods; the Instructions on pages 10 and 11 provide more appropriate guidance for exempt organizations changing their accounting period. This “TIP” might best be moved to the discussion of accounting methods on page 11, and the reference to guidance on accounting periods should be eliminated.

¹³ See, e.g., 2007 Form 990-PF Instructions at 10.

¹⁴ Reg. § 1.507-2(b)(4).

5. *When, Where, and How to File*

a. Electronic filing

The Instructions direct a filing organization to file its Form 990 electronically if it files 250 “returns” or more during the calendar year and has assets of \$10 million or more. The Instructions direct such organizations to the Service’s efile web site (www.irs.gov/efile) for further information.

A short parenthetical explanation of the rules for counting “returns” for the 250 return requirement might help eliminate a trap for the unwary. Thus, for example, the Instructions might state that organizations filing 250 or more returns “(counting each Form W-2 or Form 1099 filed for each employee or independent contractor as a separate return)” must file electronically if the organization has assets of \$10 million or more.

b. Attachment for explanation of late filing

The Instructions indicate that organizations not filing Form 990 by the due date should attach an explanation of the reason why the return was not timely filed. However, the Instructions do not indicate a specific location for attaching such an explanation.

We suggest that the Instructions require that any explanation of reasonable cause for failure to timely file Form 990 be included in Schedule O, consistent with the overall methodology of the Form 990 revision process in eliminating unstructured attachments. If such explanations were always located on the same schedule, it would be more likely that procedures could be developed by the Service for the evaluation of such explanations prior to sending out penalty notices for the late filing of Form 990.

6. *Amended Return/Final Return*

The Instructions contain the helpful suggestion to use Form 4506 to obtain a complete copy of a prior return filed by an exempt organization. However, organizations filing Form 4506 must often wait some time for a response.

Organizations amending their returns often do not need all of the schedules, and copies of prior returns are available on the web sites of organizations which receive public disclosure copies from the Service for the purpose of making the returns publicly available. These copies are, for the most part, available without charge. It would be helpful for the Instructions to reference these websites, www.guidestar.org and www.eri-nonprofit-salaries.com.

7. *Failure to File Penalties*

The Instructions indicate that a penalty may be charged for an incomplete return for failure to make an entry on all lines requiring an amount, “including a zero when appropriate.” For organizations using professional preparers and computer software, this requirement is not burdensome. However, for organizations relying on volunteers to prepare the Form 990, entering a zero on each line where the organization has nothing to report is time-consuming. We suggest that the Service eliminate this requirement.

8. *Requirements for a Properly Completed Form 990*

a. Recordkeeping

The Instructions state that records supporting items of income or deduction “usually” must be kept for three years from the later of the date of filing of the return or its due date. This period was presumably selected because it conforms to the general rule in the Code providing for a three-year statute of limitations.¹⁵

We are concerned that the suggestion of a three-year period may lead organizations to discard records before the applicable statute of limitations has expired. The statute of limitations for the examination of a return may be considerably longer than three years; for example, the limitations period for examination of returns containing substantial omissions of gross income is six years.¹⁶ We suggest that the Instructions be modified so that the recommended period is no shorter than seven years.

b. Completing all lines

The Instructions indicate that no lines should be left blank, even if the organization has nothing to report. For organizations using professional preparers and computer software, this requirement is not burdensome. However, as noted above in these Comments, for organizations relying on volunteers to prepare the Form 990, entering a zero on each line where the organization has nothing to report is time-consuming. We suggest that the Service eliminate this requirement.

B. Heading, Part I and Part II Instructions

1. *Completing the Heading of Form 990*

a. Checkboxes

(i) Name change

The Instructions indicate that if the organization has amended its governing documents to change its legal name, the organization must attach to its Form 990 a copy of the amended governing documents. Articles of amendment for a corporation must evidence that they have been filed with the state of incorporation. Similar requirements are imposed upon charitable trusts and unincorporated associations.

Organizations amending their governing instruments often file the amended documents with the Service in advance of filing their annual Form 990. Organizations changing their name are often anxious to have the new name reflected in the Cumulative List of Exempt Organizations,¹⁷ so it is quite likely that an organization that has filed articles of amendment to

¹⁵ Section 6501(a).

¹⁶ Section 6501(e).

¹⁷ Internal Revenue Service, Cumulative List of Organizations described in Section 170(c) of the Internal Revenue

change its name will have already filed such articles of amendment with the Service. The Instructions should, at minimum, indicate whether the Service intends that organizations which have already filed copies of their amended governing documents with the Service must also include a copy with the Form 990. We suggest that the Instructions permit organizations which have already filed copies of their amended governing documents with the Service to avoid filing them again with Form 990.

(ii) Application pending

As noted above, organizations which have not yet filed an exemption application might appropriately file Form 990. We suggest that the Instructions provide that such organizations should check the “application pending” box.

b. Employer identification number

The Instructions contain helpful information to avoid common errors. We suggest that the Instructions also note that organizations that are part of a group exemption letter must use their own identification number, rather than the identification number of the parent or central organization.

c. Type of organization

The Instructions require that the organization describe its form of organization under the law of its state of domicile. Given that not for profit corporations are with some regularity administratively dissolved in some states for failure to file annual corporate reports,¹⁸ a sentence to provide guidance for an entity in this situation might be helpful. We suggest the following: “If the organization is a corporation which has been administratively dissolved under state law, and which intends to seek reinstatement of its corporate status, check the ‘corporation’ box.”

2. *Part II Signature Block*

a. Paid preparer

The second paragraph of this portion of the Instructions (page 4) indicates that a paid preparer must generally sign the return. We suggest that the following clarification—“An employee of the filing organization is not a paid preparer”—be added immediately after this sentence in order to eliminate a common source of confusion.

b. Authorization to discuss return with paid preparer

The Instructions indicate that a “yes” in the checkbox authorizing the Service to contact the paid preparer authorizes the Service “to contact the paid preparer to discuss any matter relating to this return.” The Instructions do not indicate whether it is the practice of the Service

Code of 1986, Publication 78, *available at* <http://www.irs.gov/charities/article/0,,id=96136,00.html>.

¹⁸ Internal Revenue Service, Operational Requirements for Exempt Organizations FAQ #6, *available at* <http://www.irs.gov/charities/article/0,,id=170854,00.html>.

in such situations to also concurrently provide notice to the organization when the paid preparer is contacted. We suggest that the Instructions provide this information in order that organizations can make an informed choice as to whether to authorize preparer contact which could result in additional fees to the organization, or to instead require that the Service first contact the organization, rather than the preparer.

C. Part III (Statement of Program Service Accomplishments) Instructions

1. *Mission*

The last sentence of the Instructions under the heading “Mission” states that “[i]f the organization does not have a mission that has been adopted by its governing body,” the organization should leave blank the space for the description of the organization’s mission. We believe this sentence is likely to be confusing to most organizations.

No section 501(c)(3) organization which has received a determination letter from the Service since 1959 should have been able to do so without an appropriate description of its exempt purpose in its organizational documents.¹⁹ Similarly, other exempt organizations should have provisions in their governing documents indicating that they meet the statutory requirements for an exempt purpose.²⁰ If the organization has not adopted some elaboration on the purposes stated in its organizational documents, these purposes are its “mission.” It is misleading for the Instructions to suggest that organizations which have not formally adopted an elaborate mission statement to expand upon the purposes in their governing documents lack a “mission.”

The Instructions also are likely to confuse organizations that have various purposes in the governing documents, and have also adopted some elaboration on these purposes in a mission statement. We suggest that the Instructions avoid this confusion by restating the first sentence under the “Mission” heading to read as follows: “Describe the organization’s *purposes or mission as articulated in its governing documents (including articles of incorporation and bylaws) and/or mission statement or as otherwise adopted by the organization’s governing body.*” (Added language in *italic.*)

2. *New/changed program services*

The Instructions call for a description on Schedule O of new “significant” program services or “significant” changes in how program services are conducted. The Instructions do not provide guidance to organizations as to what is “significant.” We suggest that the Service consider adding a test for significance in the form of a percentage of revenues or expenses to clarify this requirement. For example, an organization adding or discontinuing a program which accounts for five percent or more of total program service expenditures might be required to report this change on Schedule O.

¹⁹ Reg. § 1.501(c)(3)-1(b).

²⁰ See, e.g., Reg. § 1.501(c)(6)-1.

3. *Program service accomplishments*

a. Expense measurement

The Instructions direct the filing organization to report various information regarding its “three largest” program services measured by the “total expenses incurred” for such programs. We suggest that the Service consider adding a parenthetical after the phrase “total expenses incurred” indicating that total expenses incurred do not include “donated services or use of donated materials, equipment, or facilities.” This information is set forth on the next page, but it would be helpful to the reader of the Instructions if it were also set forth in connection with the initial directions regarding expense computation.

b. Additional examples of program service descriptions

The Instructions provide helpful suggestions for describing various measures of program service accomplishments. However, these measures seem to be directed primarily at organizations described in section 501(c)(3).

We suggest that the Service consider adding other examples to fit some of the other types of organizations that will be filing the new Form 990. Appropriate examples might include the following:

(i) Trade associations/business leagues

Describe the number of members who attended organization events or received organization communications; industry standards produced; or legislation, regulations, or judicial or administrative proceedings the organization sought to influence.

(ii) Social clubs

Describe the facilities of the organization (golf, tennis, dining), the number of members served, and the hours of operation of the organization’s facilities.

(iii) Veterans organizations

Describe the recreational and other facilities maintained for the benefit of members, the hours of any facilities, the community and patriotic activities of the organization, and assistance to wounded veterans and their families; provide the number of veterans and others served by the organization.

D. Part IV (Checklist of Required Schedules) Instructions

1. *Line 1. Schedule A, Public Charity Status and Public Support*

The Instructions direct an organization that *is* a section 501(c)(3) organization (other than a private foundation) to file Schedule A. Other organizations are directed to answer “no” and to omit Schedule A.

Organizations checking the “application pending” box on page 1 should also be directed to file Schedule A if they are seeking a determination that they are public charities described in section 501(c)(3). The reporting of the basis for the claim of public charity status by such organizations on Schedule A is appropriate. As recommended above, we also believe it would be appropriate to require organizations which have not yet filed their exemption application, and which intend to seek section 501(c)(3) status, to file Schedule A.

In addition, for the reasons set forth above, we also recommend that private foundations in the fifth year of a sixty month termination period also file Form 990, rather than Form 990-PF, and file Schedule A to demonstrate that they have met the requirements for termination of their private foundation status.

2. *Line 2. Schedule B, Schedule of Contributors*

a. Section 501(c)(3) organizations meeting the public support test

The Instructions indicate that section 501(c)(3) organizations meeting the one-third public support test under sections 509(a)(1) and 170(b)(1)(A)(vi) must file Schedule B only if they receive a contribution from a contributor which exceeds the greater of \$5000 or two percent of the organization’s total gifts, grants, and contributions. Section 501(c)(3) organizations which do not meet the one-third public support test, and certain other exempt organizations, must file Schedule B if they receive more than \$5000 of contributions from any one contributor. We believe the special rule for organizations which meet the one-third public support test needs clarification to reflect the redesigned Schedule A.

The Instructions, both for the above-referenced line of the Core Form and for Schedule B, do not specify *when* the organization must meet the one-third public support test in order for the special rule above to apply. We suggest that the Service consider modifying the Instructions to state that the special rule is applicable if the organization meets the one-third public support test “for either the current or the prior year (as shown on Schedule A, Part II, lines 14 or 15).”

b. “Other” organizations

The Instructions also provide that “[a]ny other” organization must report contributions from any one contributor in excess of \$5000. The Instructions do not otherwise provide any examples of the sorts of contributions which are to be reported.

Most users of Schedule B are likely to be organizations eligible to receive contributions that are deductible as charitable contributions because the recipient organization is described in section 170(c). However, other exempt organizations also are subject to reporting contributions on Schedule B, even if such “contributions” are not tax deductible charitable contributions.²¹ An example to emphasize this point, such as a nondeductible contribution of \$25,000 made by an individual to a section 501(c)(4) organization to fund lobbying expenditures, would be helpful.

²¹ Reg. § 1.6033-2(a)(2)(ii)(f).

3. *Line 9. Escrow account liability, custodial arrangements, or credit counseling*

The Instructions attempt to explain, with some success, the widely divergent arrangements under which a filing exempt organization may hold funds for the benefit of others, all of which are to be reported on Schedule D, Part IV. The Instructions are relatively clear with respect to credit counseling organizations and debt management. However, we suggest that the Service consider additional clarification with respect to other types of arrangements for other purposes.

The balance sheet in the Core Form (Part X, line 21) requires organizations to report “Escrow account liability.” The Instructions for Part X, line 21, describe the line as including “the amount of funds or other assets held for other individuals or organizations,” if the corresponding assets are also included on the balance sheet. If the organization has signature authority or another interest in an escrow account, but does not report the assets on the balance sheet, the amounts are described and reported on Schedule D, Part IV. There is no definition of “escrow account” in the Glossary.

Part IV, line 9, of the Core Form does not use the word “escrow,” but instead refers to amounts not listed on the balance sheet over which the filing organization serves as “custodian.” This word likewise is not defined in the Glossary.

The terms “escrow” and “custodial” accounts are likely to connote for most exempt organizations special bank accounts bearing the referenced terminology. However, exempt organizations commonly pool funds for joint efforts which are not set aside in special bank accounts; often these funds are merely reflected on the books of the “sponsor” of the particular joint program or “agent” for the participating organizations. If the Service intends that these funds should be reported on Schedule D, Part IV, and Part IV, line 9, of the Core Form, we suggest that the current Instructions using the “escrow” and “custodial” terms be modified to read as follows:

Answer “yes” if the organization reports an amount on Part X, line 21; holds funds for the benefit of other organizations; or provides credit counseling, debt management, credit repair, or debt negotiation services.

An organization holds funds for the benefit of other organizations if it maintains an account at a financial institution, or an account on its books and records, where funds are held for the benefit of one or more other organizations. An organization is treated as holding funds for the benefit of other organizations if, for example, the organization maintains an account on its own books in which it records funds collected from other organizations for a joint project, and the related expenditures. Similarly, an organization holds funds for the benefit of other organizations if it maintains signature authority over a bank account for the collection and disbursement of such funds, irrespective of whether that account is denominated as an “escrow,” “custodial,” or “trust” account, or some similar term, by the financial institution holding the funds.

4. *Line 10. Endowments*

Endowments which are restricted only by action of the governing body of the organization, rather than by donor restriction, are commonly referred to as “board designated” endowments. The Instructions would be more understandable to exempt organizations if the term “quasi endowment” was followed by a parenthetical indicating that the term includes “board designated” endowment.

5. *Line 11. Balance sheet schedules for certain investments and liabilities*

The Instructions for Part IV, line 11, direct organizations to provide a “yes” answer and complete the relevant portions of Schedule D if the organization has made entries on certain lines of the balance sheet. Part X, the balance sheet, similarly provides a direction to complete the relevant portions of Schedule D if entries appear on lines 12, 13, and 15 of the balance sheet (investments in other securities, program related investments, and other assets, respectively).

The Instructions for Schedule D, however, appropriately require completion of the detail on Schedule D with respect to lines 12, 13, and 15 of the balance sheet only if various monetary thresholds are exceeded. We recommend that the Service consider adding a cautionary sentence to the Instructions for Part IV, line 11, stating that the relevant portion of Schedule D needs to be completed for entries on lines 12, 13, and 15 of Part X only if certain monetary thresholds are exceeded.

6. *Line 12. Audited financial statements.*

The Instructions indicate that an organization must provide a “yes” response and complete Schedule D, Parts XI through XIII, the reconciliation of the Form 990 amounts to the audited financial statements of the organization.

As recognized by Part XI, line 2a, of the Core Form, some exempt organizations engage accountants to provide only a compilation or review, rather than an audit. We suggest that the Service consider adding to the Instructions a statement that organizations which obtain only an accountant’s compilation or review, rather than audited financial statements, should answer “No.”

7. *Line 14b. Revenues greater than \$10,000 from activities outside of the United States*

Line 14b of Part IV of the Core Form asks whether the organization had “aggregate revenues or expenses of more than \$10,000 *from* grantmaking, fundraising, business, and program service activities outside the U.S.?” (Emphasis added.) The Instructions do not elaborate upon the meaning of this line.

The use of the word “from” in this question may be confusing to organizations in relation to revenues “from” grantmaking and program services. Ideally, the language on line 14b of the Core Form itself would appropriately be revised to inquire about aggregate revenues or expenses “*from or attributable to*” grantmaking, fundraising, business, and program service activities outside the United States. However, even if the Core Form cannot be revised, we suggest that

the Service consider expanding the Instructions to explain that the word “from” in line 14b means “from or attributable to.”

The same issue arises in the heading for Schedule F, Part I, and the related Instructions. We recommend that the Service consider a corresponding change in Schedule F if possible, and also expand the Instructions to Part I of Schedule F.

8. *Line 15. Grants or assistance greater than \$5000 to organizations outside the United States*

Line 15 asks whether the organization made more than \$5000 of “grants or assistance to any organization or entity located outside the United States?” (emphasis added). The Instructions to line 15 of Part IV of the Core Form do not elaborate on the meaning of line 15.

The term “entity,” as used in line 15, is not defined in the Glossary. Nor does the Glossary define “organization” outside the context of the filing organization. Line 15 also differentiates on the basis of the organization’s or entity’s location, as opposed to the location where the organization or entity was created and organized.

In contrast, the Glossary does contain definitions of the terms “foreign organizations” and “foreign government.” The definition of “foreign organizations” is based on the location where the organization was “created and organized.”

Line 15 may be confusing to filing organizations because it may be thought to include domestic organizations that carry on activities outside the United States. Accordingly, if possible, we suggest that the Service consider rephrasing line 15 to inquire about grants or assistance to any “foreign organizations and/or foreign governments.” In any event, the Instructions should define the phrase “organizations or entities located outside the United States” to mean “foreign organizations and foreign governments,” as used in the Glossary.

The same issue arises in the heading on Schedule F, Part II. We suggest that the Service consider revising the heading to say “**Grants and Other Assistance to Foreign Organizations or Foreign Governments.**” Even if such a change is not possible on Schedule F itself, we suggest that the Service consider clarifying the Instructions to Part II of Schedule F accordingly.

9. *Line 29. Non-cash contributions*

a. Coordination with statement of revenue.

The Instructions provide that “organizations are required to answer “Yes” to line 29 if they received during the year more than \$25,000 in value of donations, gifts, grants or other contributions of property other than cash, *regardless of whether they reported such amounts as non-cash contributions in Part VIII, line 1g.*” (Emphasis added.)

It is not clear why the Instructions to Part IV should imply that completion of line 1g of the statement of revenue (Part VIII) is optional. The Instructions to the statement of revenue do not appear to provide any option to avoid the completion of line 1g. We suggest that the

italicized language above be eliminated or, alternatively, that it be replaced with language indicating that such amounts should also have been reported on Part VIII, line 1g.

b. Contributions to capital

The last sentence of the Instructions for line 29 also requires organizations to exclude “contributions to the capital of the organization” in determining their response. The Instructions for line 30, relating to contributions of art, historical treasures, and similar assets, contain a similar direction.

For organizations described in section 501(c)(3), which represent the predominant category of Form 990 filers, contributions to capital are unlikely to occur. If it is important that such contributions be excluded from reporting, we suggest that the Service consider providing an explanation of the sorts of contributions that would constitute capital contributions such as, perhaps, contributions of certain property to a social club described in section 501(c)(7). Otherwise, we recommend that the discussion of capital contributions be eliminated.

10. *Line 37. Conduct of substantial activities through an unrelated partnership*

The Instructions for line 37 contain a helpful test—five percent of exempt organization gross revenue or total assets—for identifying the partnerships that are required to be reported. However, the Instructions identify the partnerships to be reported on line 37 as an “unrelated” partnership or organization. This terminology may be confusing.

What appears to be intended by the Instructions is that line 37 is used to report participation in partnerships that are not treated as “related” under the definitions provided in the Instructions for Schedule R. However, an exempt organization conducting substantial activities through a partnership which nonetheless does not meet the definition of a “related” organization for purposes of Schedule R may not view such a partnership as “unrelated.” We suggest that the Service consider, instead of the term “unrelated,” using the phrase “Conduct of substantial activities through other partnerships” in the heading to the line 37 Instructions. In the first sentence of the text, rather than describing the partnership as “an unrelated organization that is taxed as a partnership for federal income tax purposes,” the Service may wish to instead consider “an organization that is taxed as a partnership for federal income tax purposes that is not otherwise classified as a related organization for purposes of Schedule R.”

E. Part V (Statements Regarding Other IRS Filings and Tax Compliance) Instructions

We do not have any comments regarding Part V.

F. Part VI (Governance, Management, and Disclosure) Instructions

Form 990, Part VI, indicates that Sections A, B, and C “request information about policies not required by the Internal Revenue Code.” However, there is almost no discussion of this statement in the Instructions.

Although many of the governance practices listed in Part VI are “best practices” not expressly required by the Code in most cases,²² the absence of appropriate governance procedures may lead to opportunities for excess benefit transactions, operation for nonexempt purposes, or other activities inconsistent with section 501(c)(3) status or the organization’s exempt status under other provisions of the Code. Such activities are legitimate triggers for selection of an organization for examination by the Service, and the Service therefore may find the responses to the governance questions to be productive of examination adjustments.

Rather than simply leaving without significant elaboration the naked statement regarding governance on Part VI of Form 990, we suggest that the Service include in the Instructions a brief explanation of the meaning of the statement on Form 990 and the reasons the Service considers governance relevant to compliance. The recent statements by Steven T. Miller at his April speech at Georgetown University would provide a good starting point.²³

1. *Governing Body and Management (Section A)*

a. Line 1b. Independent voting members

The Instructions contain four tests, all of which must be met, in order for a director to be counted as “independent.” The director cannot be independent if: (1) the director receives any amount of compensation as an officer or employee of the organization; (2) the director receives more than \$10,000 per year from the organization in an independent contractor capacity; (3) the director receives material financial benefits from the organization or a related organization; or (4) a family member of the director receives any compensation or other material financial benefits from the organization.

(i) *Compensated directors*

The Instructions regarding the second factor include an example which states that “a person who receives reasonable expense reimbursements and reasonable compensation as a director of the organization does not cease to be independent merely because he or she also receives payments of \$7,500 from the organization for other arrangements.” It would be helpful for this example to include amounts of director compensation to make clear that the fact that a director is compensated does not mean that the director is not independent. Thus, for example, the example might indicate that the director receives \$3000 per meeting for quarterly meetings to make clear that the \$10,000 limitation is not applicable to compensation the director receives in his or her capacity as such.

²² *But see, e.g.*, Section 509(f) (donor control not permitted for certain “supporting organizations” otherwise described in section 509(a)(3)).

²³ Remarks of Steven T. Miller, Commissioner, Tax Exempt and Government Entities, Internal Revenue Service, April 23, 2008, reproduced on the Service’s web site at http://www.irs.gov/pub/irs-tege/gulc_governance_speech_042308.pdf.

(ii) Interaction between factors

The fact that there is no dollar limit on family member compensation can lead to perverse results. For example, if an organization with directors who are uncompensated permits the board chair to bring a spouse to a meeting at a substantiated cost of \$1000, and treats the reimbursement of the spouse's travel expenses as the payment as taxable compensation, whether the director is still treated as independent depends upon which party the organization pays. If the spouse is reimbursed directly by the organization, the director automatically ceases to be an independent director because a family member has received compensation from the organization. On the other hand, if the director pays for the spouse to attend and receives the reimbursement, the director presumably continues to be independent.

Similarly, if the son of a director receives \$500 in reasonable compensation for working at a local food pantry over the summer unloading boxes, this seems unlikely to cause the director to cease to exercise "independent" judgment as a board member.

We suggest that the Service consider adding a minimum amount of compensation for a family member of a director that would cause the director to cease to be independent. Consistent with the second factor (the amount a director can receive personally as an independent contractor), we believe \$10,000 would be a reasonable amount.

b. Line 2. Relationships among officers, etc.

(i) Relationship disclosure

The Instructions require that "family" or "business relationships" among officers, directors, and key employees of an exempt organization ("listed persons") be disclosed. A "business relationship" includes the direct or indirect transaction of business between the two directors involving more than \$5000 per year. An "indirect transaction" includes a transaction with an enterprise in which a director of the exempt organization serves as an officer, director, key employee, or greater-than-35% owner.

In providing this degree of disclosure, a listed person would not only need to evaluate each business relationship involving more than \$5000 for the year, but would need to know or learn for each such business relationship whether another listed person also is a director, officer, key employee or greater-than-35% owner of the other entity involved. Such inquiries may be so burdensome that individuals will be reluctant to serve as volunteer board members.

As written, the Instructions are likely to require a great deal of effort by exempt organizations and their directors or trustees to identify routine commercial transactions which should not cause any basis for concern. For example, if one of the members of the board of a small liberal arts college is a key employee of one of the local utilities serving the community in which the college is located, other board members filling out their annual conflict and other disclosure form who own or are officers, directors, or key employees of businesses or professional practices in the community are going to have to determine the amount their businesses paid the local utility in order to determine whether a reportable business relationship exists. It is difficult to understand why such routine transactions should be cause for concern by the Service or readers of Form 990.

We recommend that, instead of a fixed dollar amount, the Service require reporting only of relationships which exceed a percentage of the entity's gross revenues. Thus, for example, disclosure could be required of transactions which exceed five percent of the revenues of the entity with which either director or other listed person is affiliated. Such a change would eliminate unnecessary busywork for exempt organization directors while still requiring the disclosure of business relationships that are sufficiently significant that they could give rise to a realistic possibility that one or more directors might fail to exercise independent judgment because of influence exercised by another listed person.

(ii) "Family" definitional issues

For purposes of line 2, "family" is defined as including an individual's ancestors and spouse, as well as siblings, children, and grandchildren and their respective spouses.

The Glossary definition of family is the same, except that great grandchildren and their respective spouses are included. The Glossary definition is preceded by the qualifying language, "[u]nless specified otherwise."

We certainly applaud the Service's limitation of the "family" definition for disclosure of relationships among officers, directors, and key employees. However, filing organizations may be confused by the need to apply different definitions, particularly since one of those other instances is in the application of the test for "independence" of directors on line 1b of Part VI. This line classifies a director as not possessing "independent" status if the director's great grandchild, or the great grandchild's spouse, receives compensation from the organization.

We suggest that the Instructions either highlight this difference by indicating that the "family" definition for purposes of line 2 is to be applied for line 2 only. Alternatively, the line 1b instructions could also use the same definition of "family" as is provided for line 2.

c. Line 4. Changes to organizational documents

(i) Filing requirements

The Instructions require organizations to describe, on Schedule O, significant changes to their governing documents, and to report any changes made since the filing of their last Form 990. The Instructions require a description of the changes, rather than the attachment of a copy of the changes to the governing document (except in the case of a name change).

Organizations amending their governing instruments often file the amended documents with the Service in advance of filing their annual Form 990. The Instructions should, at minimum, indicate whether the Service intends that such organizations must still describe the governing document changes on Schedule O. We suggest that the Instructions permit organizations which have already filed copies of their amended governing documents with the Service to avoid describing them on Form 990.

In addition, we question whether a summary of changes in the organization's governing documents should be preferred over the attachment of the actual changes. Summaries create the possibility of mistakes. The organizational documents themselves are the best evidence of their

contents, and we recommend that the Service continue to require that they be attached to Form 990, if the return is not filed electronically,²⁴ and if they have not already been filed with the Service.

(ii) Policies distinguished from governing documents

The Instructions state that organizations are not required to report changes to policies established or described outside of the governing documents. The examples in the Instructions of changes to the enabling document or bylaws that should be reported include changes “in the policies or procedures regarding compensation of officers, directors, trustees, or key employees, conflicts of interest, whistleblowers, or document retention and destruction.”

Although some organizations include a conflict of interest policy in their bylaws, it is relatively uncommon for organizations to include whistleblower, document retention or destruction, or compensation policies in bylaws or other organizational documents. Inclusion of these items in the list of changes that must be reported to the Service is likely to be confusing to organizations. We suggest that the Service consider removing these examples of governing document changes which should be filed with the Service.

d. Lines 6 and 7. Members or stockholders and their rights to elect or approve decisions of the organization’s governing body

The Instructions to line 6 require not for profit corporations to disclose whether they have “members” with rights to distributions upon the dissolution of the organization or rights to elect the organization’s governing body or approve decisions of the governing body. The Instructions for lines 7a and 7b require disclosure of whether various persons (irrespective of whether they are denominated as “members” in the organization’s governing documents) have the right to elect or appoint members of the organization’s governing body or approve or ratify decisions of the organization’s governing body.

The wide diversity of practice among exempt organizations in denominating individuals or organizations as “members” makes it unlikely that line 6 will yield consistent reporting of relationships that the Service may be concerned about, at least as the Instructions are currently written. For example, if a professional association has no voting “members,” but various other professional groups are afforded the right to appoint or designate one or more members of the association’s governing body, the Instructions would call for a “no” answer as to whether the organization has “members.” However, the same professional association just as easily could have been organized with classes of members with the right to elect one director of the association, and no other voting rights, which would call for a “yes” response on line 6. Questions which call for different answers based on insignificant changes in terminology are unlikely to be helpful to either the Service or the potential readers of Form 990.

²⁴ It would be desirable for electronic returns to also permit attachments containing the actual text of amendments to the organization’s governing documents. However, if the efile technology does not permit such attachments, they nonetheless should be preferred for those organizations which are not required to file electronically.

Rather than attempt without any reasonable prospect of success to develop a definition of “members” relating to voting rights, we suggest that the Service consider eliminating the second and third factors which the Instructions indicate call for a “yes” answer (member election of governing body or member ratification of governing body decisions). If these factors are eliminated, line 6 will then call for a “yes” response only if members have “equity” like rights which might entitle them to distributions or the benefits of the organization’s activities. Rights to participate in governance can be disclosed by the responses to lines 7a and 7b, without the use of the “member” terminology.

e. Line 8. Documentation of meetings and actions

The Instructions for line 8 describe the manner in which an organization “contemporaneously” documents its meetings and actions, and indicates that such documentation may be provided under “any means permitted by state law.” However, the Instructions then go on to provide that such documentation may include board approved minutes, “strings of e-mails,” and other similar writings.

We believe that the reference to e-mails in the Instructions may suggest to organizations that their minutes can be approved by a board or committee in a manner which is not consistent with state law in many states. Rather than the reference to “strings of e-mails,” we suggest that the Service consider substituting the language “electronic communications (if permitted by state law).”

f. Line 9. Local chapters, branches, or affiliates

Line 9a’s Instructions, in describing the sorts of organizations that may be affiliated with a “parent” exempt organization, indicate that the question is intended to cover “organizations over which the organization has the legal authority to exercise supervision and control, such as subordinate organizations in a group exemption, *as well as local units that are not separate legal entities under state law over which the organization has such authority.*” (Emphasis added.) The italicized language may be confusing to “parent” exempt organizations that have group exemptions, but which permit their local chapters to operate as unincorporated associations.

We recommend that the Service consider eliminating the italicized language to eliminate a source of potential confusion and complexity as to the nature of unincorporated entities under state law. As the recent discussion draft of the Revised Uniform Unincorporated Nonprofit Association Act states, unincorporated nonprofit associations “are governed by a hodgepodge of common law principles and statutes governing some of their legal aspects.”²⁵ We suggest that the Service modify the first part of the referenced sentence to include the exercise of “direct or indirect” supervision and control in order to cover supervision of local chapters through license agreements with members or officers thereof.

In addition, we suggest that the Service consider clarifying the Instructions to indicate whether the term “affiliates” is intended to cover common structures used by large exempt

²⁵ Revised Unif. Unincorporated Nonprofit Ass’n Act, at 1 (Interim Draft, Mar. 2008), *available at* <http://www.law.upenn.edu/bll/archives/ulc/hunaa/march%202008%20interim%20draft%20clean.pdf>.

organizations. For example, the “parent” corporation of a hospital system, or a university, may serve as the sole member, or have authority to appoint the board, of a number of subordinate corporations. The “local chapter” and “branch” terminology of line 9 seems instead to call for disclosure of relationships common among service clubs or other organizations operating under group exemptions with many local chapters. Nonetheless, the Instructions do not clearly state that “affiliates” is so limited, so some large organizations which operate with a common “parent” are also likely to respond “yes” to line 9 as the Instructions are written. We recommend that the Service limit the application of line 9 to organizations operating under group exemptions with local chapters.

g. Line 10. Governing body review of Form 990

Line 10 asks if members of the organization’s governing body were provided with a copy of Form 990 before it was filed. The Instructions indicate that a “yes” response is appropriate only if a copy, “as ultimately filed” with the Service, “was provided to each voting member of the organization’s governing body, whether in paper or electronic form, prior to its filing.”

It is now quite common for organizations to provide documents to board members through a special web page which directors can access in advance of meetings. We suggest that the Instructions clarify that such a method of distribution is indeed “providing to” each director the Form 990, even though the organization has not made an individual distribution to each director.

In addition, the requirement that directors be provided a copy of the Form 990 in the form “as ultimately filed” with the Service is likely to mean that there will be no opportunity for discussion of the document at a meeting, or that organizations will extend the filing of their Form 990 until the last possible extension date in order to make sure that the document presented to the board of directors is the return “as ultimately filed.”

Large boards of directors, such as those found at colleges and universities and other large charitable organizations, commonly meet only a few times a year. If discussion of a draft will not suffice, given the time necessary to prepare and finalize the Form 990, organizations will often be forced to extend the time for filing their return in order to coincide with dates of board meetings. Such extensions necessarily postpone the public disclosure of the Form 990.

If board meeting dates will not accommodate the opportunity for the board to see the Form 990 in its final form at a meeting, organizations will likely distribute it to board members without the opportunity for discussion prior to the filing of the return.

In addition, if the organization does complete its return in time to have a discussion of the return at a board meeting, the requirement that the board see the return “as ultimately filed” means that changes resulting from discussions at the board meeting will require yet an additional distribution to the board, and perhaps an additional meeting.

We suggest that the Service consider whether there are better means for promoting board attentiveness to the Form 990 than requiring that the final return be distributed prior to its filing. Providing in the Instructions that distribution of a draft in advance of a board meeting would provide organizations with flexibility to offer a meaningful opportunity for directors to review

the contents of Form 990 without causing a dramatic and undesirable increase in the number of extensions filed each year. In any event, to avoid the necessity of a second distribution of the return if changes result from a board discussion, we suggest that the Service replace the term “as ultimately filed” with “in substantially the same form as ultimately filed.”

2. *Section C. Disclosure*

In the Instructions for line 18, regarding the public availability of exempt organization returns, checkboxes are provided for the organization’s own website, “another’s website,” and upon request. Appendix D provides a detailed explanation of the public inspection procedures for exempt organization returns.

Copies of exempt organization returns are available on various public websites, including www.guidestar.org and www.eri-nonprofit-salaries.com. It is not clear from the Instructions whether an exempt organization is permitted to check the “another’s website” box simply because the organization’s returns are available on a website which gets such returns from the Service, or whether an organization is permitted to check the box only if it supplies returns to one or more websites so that such returns can be posted immediately without waiting for the website to obtain copies from the Service. We suggest that the Instructions be clarified to reflect the Service’s intent.

G. Part VII (Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors) Instructions

1. *General Instructions*

In the second paragraph of the overview of the Part VII Instructions, it is noted that reporting is required for certain individuals (key employees; current five highest compensated employees; former officers, key employees, and highest compensated employees; and former directors or trustees) only if specific dollar thresholds are exceeded. The Instructions further note that compensation from “related organizations” is to be taken into account. A parenthetical cross-reference to the Schedule R Instructions is provided to alert organizations to the need to understand the “related organizations” definition.

An understanding of the Instructions’ definition of “related organizations” is critical to the proper completion of Part VII. However, because Schedule R is the last schedule in the new Form 990, the Instructions for Schedule R unfortunately are not the first portion of the Instructions that an organization preparing Form 990 is likely to review.

We suggest that, as the third paragraph of the Instructions, the Instructions for Part VII repeat the definition of “related organization” found in the Glossary. Given the importance of this definition to the proper completion of Part VII and other portions of Form 990, the definition is worth repeating at a place where most filers are likely to read it.

2. *Section A. Officers, Directors, Trustees, Key Employees, etc.*

a. Directors, trustees, or members of the “governing body”

The Instructions define a “director or trustee” as a voting “member of the organization’s governing body.” Members of advisory boards are excluded. The Glossary further defines “governing body” as the “group of persons authorized under state law to make governance decisions on behalf of the organization.”

Some state laws permit committees of the board of directors to include non-director members. Particularly if a majority of the committee members are members of the board of directors, such committees can include committees with delegated authority to act on behalf of the board of directors with respect to certain specific matters.

We suggest that the Service consider modifying the Instructions to provide guidance as to the inclusion of non-director or officer members of committees of the board of directors. For a large organization, listing such members may be cumbersome, and including individuals who are members of one committee with limited and discrete functions may also tend to obfuscate rather than clarify the identity of those with the principal authority over the governance of the organization. Thus, the Service may wish to consider excluding non-director or officer voting members of board committees.

b. Officers

The Instructions require the reporting of compensation information for all “officers.” An “officer” is defined under the Instructions as including “a person elected or appointed to manage the organization’s daily operations, such as a president, vice-president, secretary, or treasurer.” The Instructions further direct organizations to refer to their organizing document, bylaws, or resolutions of the organization’s board of directors to determine the identity of the “officers” to be reported, but in all cases to include the officers required by applicable state law. The organization’s top management official is always treated as an “officer.”

Very large exempt organizations often have a number of vice-presidents, as well as various assistant secretaries or assistant treasurers. Such individuals also often are appointed by other officers, such as the president of the organization, rather than elected by the board of directors.

With the rather broad definition of “key employee” in the Instructions, it seems unnecessary to also require the reporting of compensation information for all officers of a very large exempt organization. We suggest that the Service consider limiting the definition of “officer” to those individuals selected by the organization’s board of directors, and adding a cautionary instruction that would require the reporting of other individuals holding officer titles only if the individual is also a “key employee.”

c. Key employees

(i) Definitional issues

The Instructions provide a helpful definition of “key employee.” A “key employee” includes individuals with responsibilities similar to officers, directors, or trustees; individuals who manage segments of the organization that account for five percent of the assets, income, or expenses of the organization; and individuals who have or share authority to control or determine five percent of the organization’s budget for capital expenditures, operations, or employee compensation.

The detail as to the individuals who are “key employees” is helpful and should be retained in the Instructions. However, for a large health care institution or college or university, the number of individuals who may be described as “key” under the Instructions may be quite large. For example, at a university, quite a number of individuals might meet the “key” definition by virtue of their authority over income or expenditures of a particular department; an altogether different group (including endowment fund investment managers and treasury personnel) likely would be “key” by virtue of the management of asset segments. In addition, an additional group of individuals sharing authority for human resources, facilities management, and other operating areas (such as food service, maintenance, or dormitories) may meet the five percent test for operating, capital, or compensation expenses.

We believe that the Instructions’ overall limitation of the definition of “key employee” to employees receiving \$150,000 or more from the organization and related organizations is very helpful and should be retained to eliminate reporting of employees whose compensation likely will not present any serious issues.

However, we further suggest that the Service consider putting some cap on the number of “key” employees for organizations filing Form 990. If the suggestion above with respect to clarification of the number of “officers” to be reported is adopted, we believe this cap should still be fairly large—perhaps 40—to avoid the potential omission of individuals whose position with the organization is sufficiently significant to present the opportunity for them to exercise substantial influence and to receive excessive compensation. However, at some point, even if the various five percent tests are met, employees sufficiently deep in the organizational structure cannot properly be regarded as “key” under any reasonable definition of the word.

If a cap on the total number of key employees is adopted, we also suggest that the Service require that the organization base its determination of the individuals fitting within the cap on the total compensation of such individuals. Thus, for example, if 41 employees both meet the five percent test for some category, but the number of key employees is capped at 40, the 40 key employees to be reported would be the 40 highest compensated employees of the 41.

(ii) Interaction with Schedule J

According to the chart on page 12 of the Instructions to Part VII of the Core Form, “[o]fficers and key employees” must be included on Schedule J if “reportable and other compensation” is greater than \$150,000. However, an individual will not be a “key employee” under the definitions set forth on page 2 of the Instructions with respect to Part VII unless the

individual has “reportable” compensation (generally W-2 compensation) of \$150,000 or more. The page 12 chart thus may suggest to readers that individuals who are not “key employees” must nonetheless be reported on Schedule J.

The page 12 chart should be corrected by separating “officers” from “key employees.” All officers (with the definitional modifications suggested above) should be listed in Section A of Part VII of the Core Form. However, only those officers who receive more than \$150,000 of “reportable and other compensation” should be listed on Schedule J.

d. Reportable compensation

The text below the helpful bullet points defining “reportable compensation” by reference to where such compensation is shown on either Forms W-2 or 1099 provides guidance to organizations that are not required to file such forms because the reportable amounts are below the relevant filing thresholds. In general, compensation paid to officers and directors needs to be reported on Part VII of the Form 990 irrespective of whether the amounts were large enough to trigger a filing of either Forms W-2 or 1099.

Although situations where an organization pays a director less than \$600 per year seem likely to occur, and therefore should be addressed, it is unlikely that many organizations will pay employee compensation to officers that is below the much lower W-2 filing threshold. Thus, the Instructions as written may cause confusion or perhaps erroneously lead an organization to fail to file a Form W-2 when otherwise required to do so.

In addition, the Instructions’ directive that organizations should “not apply this rule to related organizations” is also likely to be more confusing than helpful. As the Instructions indicate with respect to columns D and E of Part VII, Section A, compensation from related organizations need not be reported unless it exceeds \$10,000, which is far above the Form 1099 and W-2 filing thresholds.

We suggest that the language below the bullet points defining reportable compensation state as follows: “Report the actual amount paid if no Form 1099-MISC was filed because the amount paid did not exceed the filing requirement for such form, or if the organization failed to file a required Form 1099-MISC or Form W-2.”

e. Group returns

The Instructions provide guidance as to how organizations which elect to file group returns are to report the compensation of officers, directors, and other persons required to be reported. However, the first sentence of the Instructions relating to group returns, which summarizes the filing requirements for organizations with group exemptions, may give some organizations the erroneous impression that group returns are required.

We suggest that the sentence describing the group return filing requirements be redrafted as follows: “A central or parent organization (as described in General Instruction I) must (unless it is excepted from filing Form 990) file its own Form 990, and may elect to file a separate group return reporting the activities of its subordinates.”

f. Column (B). Average hours per week

The first sentence of the Instructions describing how organizations are to compute the average hours per week worked by individuals reported in Part VII, Section A of the Core Form indicates that hours are to be aggregated for services performed for the filing organization and related organizations for which compensation is also required to be reported with respect to the particular individual. However, the last sentence of the same paragraph of the Instructions states that “[h]ours devoted to related organizations may be reported in Schedule O.”

Most readers of the Instructions are likely to be confused by these two sentences. If what is intended by the Service is that Schedule O may be used to provide additional disclosure at the election of the filing organization, then the last sentence might be rewritten as follows: “If the organization desires, in addition to reporting the aggregate average hours worked for the organization and related organizations in column (B), Schedule O may be used to report separately the average hours worked for related organizations.”

g. Current and former officers, directors, and key employees

The Instructions to Part VII of the Core Form provide, on page 5, extremely important guidance as to when an individual should be treated as a “current” officer, director, or key employee. The Instructions indicate that an individual should be listed on Part VII, Section A, if the individual served in such capacity at any time during the organization’s fiscal year.

This concept is sufficiently important that it should also be highlighted in the definitions of “officer,” “director,” or “key employee.” We recommend that the Service consider adding to the definitions of these terms the phrase “at any time during the organization’s taxable year.” Thus, for example, a “director or trustee” would be defined as “an individual who, at any time during the organization’s taxable year, is a voting member of the organization’s governing body.”

The Instructions also indicate that, for the determination of whether an individual has met the threshold for classification as a “key employee” or one of the five most highly compensated employees, organizations filing their returns on the basis of a fiscal year should use the calendar year ending within the organization’s taxable year to determine whether the threshold is met. For the five most highly compensated employees, this direction is repeated in the definition of “five highest compensated employees” on page 3. This statement is also sufficiently important to warrant repetition in the definition of “key employee” on page 2 of the Instructions for Part VII.

H. Parts VIII – XI (Statements of Revenue and Functional Expenses, Balance Sheet, and Financial Statements and Reporting Methods) Instructions

1. *Part VIII Statement of Revenue*

a. Codes for program service revenue

The Instructions direct organizations entering amounts of program service revenue in column (A) of lines 2a through 2e to enter a “business code” from the Form 990-T Instructions.

The “business codes” are described in the Form 990-T Instructions as “Codes for Unrelated Business Activity.”

We suggest that the Service develop a listing of codes for program service activities and include them in the Form 990 Instructions, rather than requiring filing organizations that generally will not be required to file Form 990-T to refer to separate instructions with a title that will be confusing to many organizations.

b. Reporting income excluded from tax by other Code provisions

The Instructions for column (B) direct organizations to report income excluded from tax by provisions of the Code other than section 501(a) in column (B), which is generally used to report income from activities substantially related to the exempt purpose of the organization. The Instructions indicate that an example of such income is income on state or local obligations excluded from tax by section 103. Income received from insurance policies by virtue of the death of the insured, or income received from performing governmental functions, might be others.

There are only three columns to choose from, and none of the others (unrelated business income or unrelated business income excluded from tax by some other exclusion in sections 511 through 513) are a perfect fit. Accordingly, the choice of column (B) reporting over column (D) reporting perhaps is not of great consequence, particularly because, in the aggregate, the amount of income excluded by virtue of other Code provisions is likely to be particularly small in comparison to aggregate column (B) amounts. However, because state and local bond interest is most akin to the passive income reported in column (D), the Service may wish to consider whether column (D) might be a better choice for this sort of income and similar income from passive investment activity that is nonetheless excluded from tax under other Code provisions.

c. Line 1. In general

The paragraph at the top of page 2 of the Instructions for Parts VIII – XI indicates that organizations are permitted, but not required, to report revenue in accordance with Statement of Financial Accounting Standards 116 (“SFAS 116”).²⁶ However, the second two sentences of the paragraph seem to suggest that pledges payable to the organization must be discounted to present value, irrespective of whether the organization has adopted SFAS 116 reporting.

We recommend that the Service consider clarification of the Instructions to specify whether pledge discounting is required for all organizations, or only for those which choose to adopt SFAS 116 reporting.

²⁶ Accounting for Contributions Received and Contributions Made, Statement of Fin. Accounting Standards No. 116 (Fin. Accounting Standards Bd. 1993), available at http://www.fasb.org/pdf/aop_FAS116.pdf.

d. Line 1b. Membership dues

The Instructions for line 1b provide useful guidance as to the reporting of “membership dues” which in fact are charitable contributions. Membership dues which do not include any contribution element are instead reported on line 2.

Although the Instructions for line 2 contain the helpful observation that dues to section 501(c)(4), (5), (6), or (7) organizations ordinarily will be reflective of the fair market value of membership benefits received, it would be helpful to mention this fact as well in the Instructions for line 1b, since such organizations are likely to enter “membership dues” on the first line containing that description.

The Service may also wish to consider adding additional examples. For example, it would be useful to include in the Instructions for line 1b an example of admissions and gift shop discounts that are treated as disregarded benefits for charitable contributions purposes.²⁷

e. Line 1c. Fundraising events

The Instructions for line 1c direct organizations to report the contribution element of fundraising events on line 1c, and also again on line 8, together with amounts received for the sale of goods or services, and the related costs. The Instructions also contain a useful example regarding the sale of a book for an amount in excess of its fair market value.

We suggest that the Service consider adding another example or two to deal with common situations. For example, the Service might wish to include a “Tip” that sales of goods (such as cookies or candy) that include no contribution element must be reported only on line 8. In addition, an example of an event such as a fundraising dinner which produces costs in excess of revenues, but which still results in the receipt of charitable contributions in terms of payments for tickets in excess of the fair market value of the dinner, might be useful to illustrate that charitable contributions still must be reported on line 1c even if a particular event turns out to be less successful than planned.

f. Line 1g. Non-cash contributions

The Instructions for line 1g direct organizations to value non-cash contributions at their fair market value at the time of receipt.

Publication 561 provides helpful guidance as to the method of valuation of contributions of property. We suggest that the Service consider adding a reference to this publication in the Instructions for line 1g.

g. Line 2. Program service revenue

Line 2 provides various ways for reporting types of program service revenue. The Instructions define such services as “those that form the basis of an organization’s exemption

²⁷ Reg. § 1.170A-13(f)(8).

from tax,” and provide various examples of such revenue, including tuition paid to an educational institution, museum or performing arts organization admission revenue, and registration fees for a convention or trade show.

In the Glossary, “program service” is defined as a “major, usually ongoing, activity of an organization that accomplishes its exempt purpose.” Examples listed include “providing charity care under a hospital’s charity care policy,” higher education, grants and assistance to disaster victims, and “providing rehabilitation services to residents of a long-term care facility.”

Singling out “charity care,” as distinguished from other health care services provided by a hospital, is misleading because all services by a hospital for the benefit of the community are program services.²⁸ We suggest that the Service consider patterning the Glossary definition more closely after the Instructions for line 2 of Part VIII. Thus, the health services example might be expanded to include as a program service “providing rehabilitation or other health care services to patients of a hospital or long-term care facility.” In addition, the Glossary definition would benefit from adding some program services commonly provided by organizations which are not described in section 501(c)(3), such as qualified conventions or trade shows.

h. Line 8a. Gross income from fundraising events

The line 8a Instructions contain a helpful chart setting forth the items which are to be reported on line 8a. The chart also contains a list of items that are not to be treated as “fundraising,” but rather are to be reported somewhere else.

Because the chart does not indicate where the reporting “somewhere else” may be, and a number of the items listed are charitable contributions that should be reported on line 1 (sales or gifts of goods or services of nominal value, and solicitation campaigns that generate only charitable contributions), the chart may be confusing to some readers of the Instructions. In particular, the chart includes two types of raffles. One involves the sale of tickets or chances to be entered into “a drawing for prizes” of unspecified value. The other involves a raffle “where prizes have only nominal value.”

We recommend that the Service eliminate the example in the chart regarding a drawing for prizes of unspecified value. A sale of \$100 raffle tickets for a chance to win a new car is not a charitable contribution; on the other hand, the sale of raffle tickets for prizes of nominal value may be a charitable contribution. Mixing the two situations without elaboration is more likely to be confusing than helpful to readers of the Instructions. Instead, the Service may wish to consider a separate sentence, below the chart, explaining that raffles for prizes of more than nominal value do not result in any charitable contribution, and instead should be reported on line 9 (and, if large enough, on Schedule G).

i. Line 8b. Less direct expenses

The Instructions for line 8b are quite short, advising organizations to report on line 8b the expenses directly related to the production of income from a fundraising activity.

²⁸ See, e.g., Rev. Rul. 1969-545, 1969-2 C.B. 117, 118.

The second sentence of the Instructions regarding line 8b reference a “book example above.” It is not clear what example is being referenced. In addition, if it is the example at page 3 of the Instructions for Parts VIII through XI of the Core Form, the basis for using wholesale cost is unclear, since that example gives no indication that the charity was able to purchase at wholesale the book that it was selling for a price in excess of its retail price.

We also suggest that the Service consider providing guidance in connection with line 8b (or elsewhere) as to the treatment of donated goods for a fundraising event. For example, if a local florist donates flowers for a gala dinner, is the correct treatment to report the fair market value of the flowers as a contribution on lines 1c and 1g, and as an expense of the fundraising event on line 8b? This situation is quite common, and it would be helpful to have a specific discussion of the proper reporting in the Instructions.

In addition, it would be helpful for the Service to provide further guidance in the Instructions for Part VIII with respect to the income and expense reporting for charity auctions. In a charity auction, the charity receives donated goods (or, in some cases, the promises of future services), which are then immediately resold at the auction. The Instructions for Schedule M (page 3) indicate that organizations which receive bulk donations of clothing, household goods, and other similar items are permitted to value such items, and record the revenue and cost of goods sold, at the resale price. We suggest that the Service reference this method in the Instructions for lines 8a and 8b of Part VIII, and indicate that such method of valuation of contributions and fundraising expenses, and other good faith estimates, are acceptable for purposes of completing Part VIII and any necessary schedules.

j. Line 9. Gaming

The Instructions describe the appropriate reporting of exempt organization income from gaming activity. Organizations with significant gaming income are also required to complete Schedule G.

The Service may wish to consider including a reference to Publication 3079, Gaming Publication for Exempt Organizations, to provide additional guidance to organizations that have income from gaming activity. This publication provides helpful information regarding the withholding and excise tax consequences of certain gaming activity.

2. *Part IX Statement of Functional Expenses*

a. In general

The Instructions contain various specific requirements for allocating certain expenditures among program services, management and general, and fundraising categories. A specific example is provided for the allocation of indirect expenses for organizations using cost center accounting. A simple example is also provided for the allocation of the salary of an employee who works 60% of the time on program management and 40% of the time on fundraising.

Expense allocation is often one of the most challenging issues for organizations that are not large enough to maintain sophisticated cost accounting systems. These organizations could benefit from a relatively simple example of the allocation of indirect costs, such as occupancy,

and support staff. Such an example might include allocation of occupancy costs on the basis of square footage devoted to particular activities and support staff costs based upon the allocations of the personnel such staff support. We suggest that the Service consider adding an example of permissible allocations to provide additional guidance to filing organizations.

b. Line 4. Benefits paid to or for members

The Instructions direct organizations to report amounts, such as payments by organizations described in sections 501(c)(8), (9), or (17) to obtain insurance provided to members of such organizations, that are paid for the purpose of providing benefits to members.

As discussed in the Comments with respect to the Instructions for Part VI of the Core Form, organizations may have “members” that are not voting members for purposes of governance of the organization, or that are merely contributors to the organization. What sort of “members” the Service has in mind with respect to line 4 should be specified.

In addition, “members” of trade or professional associations, or “members” of social clubs, expect to receive some benefits from the organization. For example, members of a trade association are likely to expect to receive benefits from the organization in the form of lobbying with respect to legislation of interest to the members of the association. Members of a social club expect to be able to use the facilities of the club.

The examples in the Instructions for line 4 suggest that the Service desires that line 4 include amounts paid by the organization to provide direct benefits to individual members, rather than industry or club wide benefits that might be most appropriately reported as program services. If this is the case, we suggest that the Instructions clarify this point by stating that organizations are to report benefits to members as a group through the accomplishment of the organization’s exempt purpose as program services, rather than on line 4.

c. Line 6. Compensation to Disqualified Persons

Line 6 and the Instructions eliminate much potential complexity for organizations by indicating that organizations need not report compensation for disqualified persons if such compensation is already reported on line 5 as compensation of officers or directors.

It would nonetheless be helpful if the Service could provide an example of compensation paid to a “disqualified person” who is not included in line 5. For example, compensation paid to a founder and substantial contributor to an organization who provides services to the organization as an independent contractor might be reported on line 6.

d. Line 11. Fees for Services Paid to Non-Employees

The Instructions call for expenses for specific services, including lobbying expenses, to be reported on various lines.

Several of the specific line items reported on the various portions of line 11 also will need to be reported on other parts of the Core Form or various schedules. For example, the amount reported on line 11d as lobbying expenses should also be reported on Schedule C. We suggest

that the Service consider including directions that the amounts reported on line 11 should reconcile to the other specific lines of the Form 990 where they must also be reported.

Two aspects of independent contractor compensation seem likely to cause potential confusion and should be addressed in the Instructions. First, independent contractor compensation paid to directors and reported in Part VII would be reported on line 5. The Service may wish to consider instructing organizations to make sure that this compensation is also not reported on line 11.

In addition, in Part VII, compensation paid to the five most highly compensated independent contractors is reported on the basis of the calendar year, rather than on the basis of the accounting method and taxable year of the filing organization. The Instructions for line 5 contain a caution that for purposes of Part IX, the organization is to use its regular accounting method and taxable year, even though the amounts on Part VII of the Core Form and Schedule J are reported on the basis of the calendar year. We recommend that the Service consider repeating the same caution in the Instructions for line 11.

3. *Part X (Balance Sheet)*

a. Line 3 (Pledges Receivable)

The Instructions for line 3 indicate that it should include “pledges receivable, less any amounts estimated to be uncollectible.” Line 5, however, requires separate reporting of “receivables” from current officers and directors.

Organizations that record pledges as receivables may be confused by the two lines, and thus may report pledges from officers and directors on line 5. We recommend that the Service include in the Instructions for either line 3 or line 5 directions as to the proper location for reporting pledges from officers and directors.

b. Line 11 (Investments: Publicly Traded Securities)

Line 11 of the Core Form balance sheet requires organizations to report publicly traded securities in the aggregate. The Core Form appropriately does not require an itemization of all of the securities holdings of organizations. However, the Instructions require itemization of publicly held securities for which the organization holds more than five percent of the outstanding shares of the same class.

The Instructions for Schedule D require that organizations provide additional detail with respect to various other types of assets, including “other securities,” “program related investments,” and “other assets” (reported on lines 12, 13, and 15 of Part X of the Core Form) if such respective asset categories amount to more than five percent of the organization’s *total assets* shown on the balance sheet (line 16). Publicly traded securities are also reported on line 12 if the organization holds more than five percent of the shares of a class.

Determining an organization’s percentage ownership of a class of shares requires an organization to refer to sources outside of the financial information reported on Form 990. In addition, for all but the most well endowed exempt organizations, ownership of five percent of

the common stock of a publicly traded corporation is unlikely to occur; indeed many organizations could invest their entire endowment in a single publicly traded corporation without accumulating five percent of the corporation's common stock.

On the other hand, the Service, contributors, and various state agencies are likely to be very interested in the disclosure of holdings by an exempt organization of publicly held securities of an issuer that represent a significant percentage of the total assets of the organization. As the Instructions are now written, for example, if an organization owns a single publicly held security that represents 25% of the organization's total assets, but does not hold greater than five percent of the outstanding shares of the same class, the ownership of such securities would not be disclosed in Part X of the Core Form or Schedule D. A significant concentration of an investment in a single security evidences a lack of diversification which may be of interest to the Service, as well as to state regulatory agencies.

We encourage the Service to consider revising the Instructions to Part X, Balance Sheet, of the Core Form to require disclosure of publicly held securities of a single class that represent more than five percent of the value of the total assets reported on Part X, line 16, rather than five percent of a particular class of stock. The Schedule D Instructions (discussed below in these Comments) would also require a corresponding revision if our suggestion is adopted.

II. COMMENTS ON SCHEDULES

A. Schedule A

1. General Instructions

a. “TIP” regarding private foundations

For the reasons set forth in these Comments on the Core Form Instructions, we recommend that the Service require the use of Form 990, rather than Form 990-PF, for private foundations in the last year of a 60-month termination period in order to simplify the process by which such private foundations demonstrate that they qualify as public charities. If this recommendation is adopted, the “TIP” on page 4 of the Schedule A Instructions would require modification to note that such private foundations should file Form 990.

b. Examples regarding completion of the public support schedules

The Instructions provide two helpful examples to illustrate the proper method of completion of the public support schedules now that the Instructions direct organizations to complete such schedules using their regular accounting method, rather than the cash method required for 2007 and prior years. However, both examples assume that the organization has not changed its method of accounting for 2008.

We suggest that the Service consider incorporating in the first example, after the statement that the organization has checked the “cash” box for its current year, the phrase, “and also used the cash method of accounting for prior years.” In addition, the Service may wish to consider adopting a similar clarification for the second example regarding an organization which

has adopted the accrual method, although accrual basis taxpayers should nonetheless (as the example assumes) have been completing Schedule A on a cash basis in accordance with the directions for prior year returns.

c. Recalculation of public support for 2007

The Schedule A Instructions contain a helpful “TIP” at page 15 advising organizations using the accrual method for 2008 that they need not recalculate their 2007 public support percentage using the accrual method, rather than the cash method. We suggest that the Service consider also repeating this “TIP,” or adding a cross-reference to page 15, to page 4 of the Schedule A Instructions regarding completion of the public support schedules by accrual method organizations.

2. *Part I. Reason for Public Charity Status*

a. Supporting organization control by disqualified person

The Schedule A Instructions for line 11(e) state that a supporting organization described in section 509(a)(3) cannot be controlled by disqualified persons, and contain information regarding the definition of “disqualified persons.” However, they do not provide further information regarding the “certification” required by line 11(e).

We suggest that in the Instructions to line 11(e) the Service further explain the certification that the organization “is” not controlled by disqualified persons. Is it sufficient that control does not exist as of the end of the taxable year? Or is the certification made as of the date of the signing of the return?

b. Line 11g

The Instructions provide no guidance with respect to the completion of line 11g, relating to contributions to supporting organization by various persons. We suggest that the Service provide directions for this line.

c. Line 11h, Column (iii)

The Instructions for Schedule A indicate that a supporting organization should identify, for each public charity it supports, the basis for the public charity’s status as such.

We recommend that the Service add guidance to the Instructions explaining the information that the supporting organization may rely on in completing this line. For example, the Instructions could provide that the supporting organization might rely on the supported organization’s determination letter from the Service, the Service’s Master File, or other information from the supported organization.

3. *Part II. Support Schedule for Organizations Described in Section 170(b)(1)(A)(iv) or (vi)*

a. Line 1

(i) Membership fees or dues

The Instructions note that filing organizations should include on line 1 of the support schedule only those membership fees which are in the nature of contributions to the organization. Membership fees which are payments for admissions, merchandise, or services that are related to the organization's exempt purpose are not to be included on the line for "contributions."

Since Part VIII of the Core Form now requires separate reporting of membership fees or dues that are "contributions" (reported on line 1b of Part VIII) and program services (reported on line 2 of Part VIII), it would be helpful if the Instructions referenced these lines in explaining the completion of the public support schedule. We recommend that the Service consider adding line references to the Core Form to assist organizations with the proper reporting of "membership" dues or fees for purposes of the public support calculation.

(ii) Gross receipts from performing particular services

The Instructions pursue the laudable objective of attempting to explain the distinction between government grants treated as contributions (reportable on line 1 of the support schedule) and gross receipts from performing the organization's exempt function, which are reported on line 12. The Instructions do not, however, provide any examples of such "gross receipts."

We suggest that the Service consider adding a sentence to the Instructions describing the sorts of exempt function receipts that are to be reported on line 12. For example, the Service might indicate that "receipts for performing services to particular individuals, such as payments for health care services provided to an individual patient, are gross receipts from the performance of the organization's exempt function, and should be reported on line 12."

(iii) Unusual grants

The Instructions provide helpful and repeated cautionary statements indicating that the schedule of unusual grants the filing organization must retain for its records showing the name of the grantor and the date, amount, and description of the grant *should not be filed with the organization's Form 990*. However, the reason for excluding this information from the Form 990 is nowhere stated.

We believe the Instructions would more likely be observed if the Service indicated that filing the donor information with Form 990, Schedule A, will result in the information being available to the public. We suggest that the Service add this information to the cautionary directions in the Instructions.

b. Line 3

Line 3's Instructions provide guidance to organizations in reporting the value of services or facilities furnished without charge to the organization by a governmental unit. These amounts are included as "public support."

Some organizations may already include such support in revenue in their financial statements, while others may not. In order to make clear that the completion of line 3 is necessary for the proper application of the public support test, irrespective of whether the organization records this revenue for financial statement or other purposes, we suggest that the Service consider adding the following additional sentence: "Report the value of such services or facilities whether or not the organization includes this amount as revenue on its financial statements."

c. Line 5

The Instructions properly indicate that the two percent public support limitation does not apply to support received from organizations that themselves are publicly supported and described in section 170(b)(1)(A)(vi), and also does not apply to other public charities described in section 509(a)(1) which would so qualify based on their support.²⁹ However, the Instructions do not elaborate upon the information the filing organization needs to determine whether organizations which do not file Form 990 (churches, conventions or associations of churches, or their integrated auxiliaries), or do not complete the support schedule in Part II of Schedule A of Form 990 (schools, hospitals, or organizations operated for the benefit of a state college or university), meet the public support test under section 170(b)(1)(A)(vi).

We suggest that the Service consider adding to the Instructions an explanatory sentence describing the information an organization needs in order to count support from churches, schools, hospitals, and similar organizations as "public support" for purposes of section 170(b)(1)(A)(vi). The following sentence would be appropriate: "In determining whether such organizations also qualify as publicly supported organizations under section 170(b)(1)(A)(vi), the filing organization may rely on information from the organization providing the support, or other credible evidence."

d. Line 8

The line 8 Instructions provide that organizations are to report income from activities that further the exempt purpose of the organization on line 12, rather than line 8. However, the line 8 Instructions provide no examples of such income.

We recommend that the Service consider including an example of program related investment income that is reported on line 12, rather than line 8. The following sentence would be appropriate: "For example, interest on student loans made by the organization to further college attendance by low-income students would be reported on line 12, rather than line 8."

²⁹ Rev. Rul. 1978-95, 1978-1 C.B. 71 (church); *see* Rev. Rul. 1976-416, 1976-2 C.B. 57 (hospital).

e. Line 9

The Instructions for line 9 direct filing organizations to enter the organization's net income from unrelated business activities.

We suggest that the Service consider adding two details to this Instruction. Although the need to include income from net unrelated activities which are not regularly carried on means that the precise information for inclusion on line 9 is not available from Form 990-T, it would nonetheless be helpful for organizations to be provided with a cross-reference to the relevant line from Form 990-T where the requested information (exclusive of unrelated but not regularly carried on activities) can be found.

In addition, the Instructions do not specify whether taxes on unrelated business income are to be subtracted, as was done in prior years. We recommend that the Service indicate the proper treatment of taxes on unrelated business income in the line 9 Instructions.

f. Line 12

Line 12 is used to report gross receipts from related activities. The Instructions contain examples of several types of payments which are to be reported on line 12.

(i) Bingo

Income from bingo games is excluded from unrelated trade or business income by section 513(f) only if "lawful." Addition of this qualification would be helpful to readers of the Instructions, and we suggest that the Service modify the Instructions to do so.

(ii) Qualified sponsorship payments

The last bullet point suggests that soliciting qualified sponsorship payments excluded from unrelated trade or business income by section 512(i) may also be treated as gross receipts from related activities.

Under the Regulations,³⁰ qualified sponsorship payments in the form of money or property are treated as "contributions." Contributions would normally be reported on line 1 of the support schedule. If there are circumstances in which the Service contemplates that such payments should instead be reported as gross receipts from related activities (perhaps in the situation where the corporate sponsor of a children's theater production purchases a large block of tickets for distribution to needy children), the Instructions should include an example of such situations. Otherwise, organizations are likely to report on line 12 corporate sponsorship payments which should be reported on line 1 as contributions.

³⁰ Reg. § 1.170A-9(e)(i).

B. Schedule B

On page 3 of the Instructions, under the general rule for contributors to be listed on Schedule B, there is a reference to section “6033(a)(2)(ii)(f)” This reference likely was intended to be to Regulation section 1.6033-2(a)(2)(ii)(f) of the Regulations.

C. Schedule C

1. *Specific Instructions*

a. Part II

The Instructions for Schedule C, on page 2, contain four bullet points corresponding to Parts I through IV of Schedule C; these points offer a helpful road map advising organizations as to the particular parts of Schedule C they must complete. According to the Instructions, Part II must be completed if the organization had any lobbying activities and checked “yes” to line 4 of Part IV of the Core Form. Part III must be completed by organizations described in section 501(c)(4), (5), or (6).

We suggest, in order to provide clearer direction to filing organizations, that the Service consider adding in the second bullet point the phrase “is a section 501(c)(3) organization and” before “had any lobbying activities.” This is consistent with Schedule C itself and other parts of the Instructions, and will reduce confusion by reinforcing that only section 501(c)(3) organizations need to fill out Part II of Schedule C.

b. Part III

The Instructions for Part III of Schedule C, and the bullet point referencing Part III described above, are somewhat confusing as to the organizations which are to complete Part III. The bullet point suggests that *all* section 501(c)(4), (5), or (6) organizations should complete Part III. Part III-A of Schedule C reinforces this conclusion by stating that it should “be completed by all organizations exempt under section 501(c)(4), section 501(c)(5), or section 501(c)(6).”

On the other hand, Part IV, line 5, of the Core Form directs section 501(c)(4), 501(c)(5), and 501(c)(6) organizations to fill out Part III of Schedule C only if they answer “yes” to the question, “Is the organization subject to the section 6033(e) notice and reporting requirement and proxy tax?” The Instructions to that part of the Core Form state: “**Line 5. Section 6033(e) notice, reporting and proxy tax.** Complete only if a section 501(c)(4), 501(c)(5), or 501(c)(6) organization. Other organizations leave this line blank.”

Under section 6033(e), an organization might respond to the question on the Core Form by indicating that it is not subject to providing its members with notice of the amount of dues devoted to lobbying or paying the proxy tax because substantially all of the dues payments to the organization are nondeductible³¹ or because the lobbying expenses of the organization do not

³¹ Section 6033(e)(3).

exceed the minimum threshold set by the statute.³² Thus, a number of such organizations are likely to answer the Core Form question “no” and skip Schedule C.

The Schedule C Instructions seem to anticipate that all section 501(c)(4), section 501(c)(5), and section 501(c)(6) organizations will complete Part III. Those organizations not subject to the notice, reporting, and proxy tax requirements because substantially all of the organization’s dues are nondeductible will answer “yes” to Part III-A, line 1.

This apparent inconsistency should be reconciled. We suggest that the Service consider editing the Core Form Instructions to clarify that organizations described in items 1, 2, and 7 of the Schedule C Instructions on page 13 (section 501(c)(4) local associations of employees and veterans organizations, section 501(c)(5) labor organizations that are not agricultural or horticultural organizations, and organizations which are not membership organizations) may answer “no” on line 5 of Part IV of the Core Form. Such organizations would then not be required to complete Schedule C and Part III-A thereof.

If this suggestion is adopted, then Schedule C, Part III-A, line 1 would require reporting only by organizations described on page 13 of the Schedule C Instructions for Part III-A in items numbered 3, 4, 5, and 6 (primarily organizations receiving dues from organizations that are not subject to tax and which therefore do not deduct dues, or organizations receiving dues from individuals unlikely to have been able to deduct such dues as an ordinary and necessary business expense). This would reduce the number of organizations filing Schedule C in order to check a single box indicating they do not need to provide further information, and is consistent with the way the question on the Core Form itself is framed.

Alternatively, if the Service wants all section 501(c)(4), section 501(c)(5), and section 501(c)(6) organizations to complete Schedule C, Part III, the Core Form Instructions for Part IV, line 5 should state explicitly that all such groups must answer “yes.”

2. *General Definition of Terms*

The definition of lobbying activities on page 3 of the Schedule C Instructions explicitly includes activities intended to influence foreign legislation, as well as national, state, or local legislation. However, the definition of political campaign activities on page 2 includes only “elective federal, state, or local public office.” This creates an implication that intervening in an election for office in a foreign country is not political campaign activity, an outcome which may not have been intended.

In order to prevent confusion among exempt organizations regarding what is and is not prohibited campaign intervention, we recommend that the Service consider revising the first sentence of the political campaign definition to read as follows: “All activities that support or oppose candidates for elective federal, state, local or other public office, whether in the U.S. or another country, are political campaign activities.”

³² Section 6033(e)(1)(B)(ii).

3. *Definitions for Part II-A*

a. Lobbying expenditures

The Instructions define “lobbying expenditures” to include expenditures for both direct and grass roots lobbying.

An often overlooked point is that “expenditures” include not only direct, but indirect, costs.³³ We suggest that, in order to reinforce this point, the Service consider adding to the lobbying expenditures definition, after the first use of “expenditures,” the phrase “including allocable overhead and administrative costs.”

b. Direct lobbying communications

The definition of “direct lobbying communications (direct lobbying expenditures)” excludes any discussion of ballot measure advocacy, an area in which many organizations incur significant expenses. The Instructions on page 6 do mention “special rules” on referenda and ballot initiatives with a reference to the Regulations,³⁴ but this reference risks getting overlooked.

We encourage the Service to consider adding to the end of the definition of “direct lobbying communications” the following: “In addition, communications with the public that refer to and reflect a view on a measure that is the subject of a referendum, ballot initiative or similar procedure are also direct lobbying communications (unless they qualify as nonpartisan analysis, study or research (see below).”

c. Nonpartisan research and analysis

At the end of the definition of “grassroots lobbying communications,” the Instructions include a sentence which states that “[a] communication described in (4) above generally is not grassroots lobbying only if, in addition to referring to and reflecting a view on specific legislation,” the communication constitutes nonpartisan research and analysis. In the next paragraph, defining “exceptions to lobbying,” a full description of the nonpartisan research and analysis exception is provided.

The referenced sentence may be confusing to readers of the Instructions in two ways. First, the reference to “(4) above” is perplexing because the reference appears to relate only to one part of the “call to action” requirement; the nonpartisan research and analysis exception applies equally to communications which otherwise include a “call to action.” Second, the nonpartisan research and analysis exception is only one of several alternative exceptions, and none of the others are referenced in the “grassroots lobbying communications” definition.

³³ Reg. § 53.4911-3(a)(1).

³⁴ Reg. § 53.4911-2(b)(1)(iii).

We suggest that the Service consider deleting the sentence immediately prior to the definition of “exceptions to lobbying.” The same point could then be made by replacing the first paragraph defining “exceptions to lobbying” with the following language:

In general, engaging in nonpartisan analysis, study, or research and making its results available to the general public or a segment or members thereof, or to governmental bodies, officials, or employees, is not considered either a direct lobbying communication or a grassroots lobbying communication. Nonpartisan analysis, study, or research may advocate a particular position or viewpoint as long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. A communication will not be treated as nonpartisan analysis, study, or research if it encourages the recipient to take action in one of the ways listed as 1, 2, or 3 above in the definition of grassroots lobbying communication.

4. *Directions to Complete the Schedule—Part 1-A Political Activity of Exempt Organizations*

The line 1 Instructions make it clear that a section 527 organization should report its exempt function activity, while section 501(c) organizations report political campaign activity, with both terms defined in the definitions. However, the Instructions to line 3 require a reasonable estimate of volunteer hours used for political campaign activities. It is unclear how this applies to section 527 organizations.

We believe that the application of line 3 should be limited to section 501(c) organizations. The use of volunteer time may be relevant in determining whether such organizations have ceased to have a primary purpose consistent with their section 501(c) status. The relevance of this information for a section 527 organization is not obvious. For the vast majority of such organizations, all of their efforts are dedicated to exempt function activities, so requiring reporting on this line would effectively mandate tracking and reporting all volunteer hours. Even when a “reasonable estimate” is allowed, the organization must have sufficient records to provide a basis for the estimate. Requiring that section 527 organizations complete this line would create a significant burden on the filer with little if any benefit for tax administration.

We recommend that the Instructions for line 3 state clearly that section 527 organizations are not required to complete this line, as follows: “Section 501(c) organizations only; section 527 organizations leave blank. If the organization used volunteer labor in the conduct of its political campaign activities, provide the total number of hours. Any reasonable method may be used to estimate this amount.”

However, if the Service intends to require section 527 organizations to provide this information, we suggest that the Instructions be amended to read as follows: “If the organization used volunteer labor in the conduct of its political campaign activities (if a section 501(c) organization), or its exempt function activities (if a section 527 organization), provide the total number of hours. Any reasonable method may be used to estimate this amount.”

5. *Directions to Complete the Schedule—Part 1-B Section 501(c)(3) Organizations: Disclosure of Excise Taxes Imposed Under Section 4955*

The questions on Schedule C, Part 1-B, ask about excise taxes “incurred” in the year. The Instructions refer to amounts “imposed.” It is not clear whether these are intended to mean the same thing, but they could be read as referring, respectively, to liabilities generated by current year activities, and taxes imposed in the current year as a result of the examination by the Service of activity in one or more prior years.

We recommend that the Service consider clarifying the Instructions to advise organizations as to whether the amounts to be reported on Part 1-B are for excise taxes attributable only to activity taking place or otherwise first reported in the current year, as suggested by the reference to filing Form 4720 “for this year,” or instead for taxes paid or liability imposed in the current year as a result of activities in a prior year. If the Service intends that both should be reported, the Instructions should so indicate.

6. *Directions to Complete the Schedule—Part 1-C Section 527 Exempt Function Activity of Section 501(c) Organizations other than Section 501(c)(3)*

a. Clarification of “its own funds” and “own internal funds”

The Instructions to Part I-C use the undefined terms “its own funds” and “own internal funds.” As explained in the Comments previously filed with respect to the draft Form 990, we believe these terms are potentially confusing and misleading.

There is no provision in the Code or Regulations defining the term “own internal funds” or “its own funds” in relation to political or lobbying activities. These phrases are probably the result of Regulations promulgated under section 527(f)(3) referring to political contributions or dues collected (typically from members) by a section 501(c) organization and then promptly and directly transferred to a separate segregated fund (“SSF”).³⁵ Earmarked check-off union dues are a familiar example. As explained by the “Note” preceding the Instructions for lines 1 and 2, prompt and direct transfers of such earmarked monies are not exempt function expenditures for the section 501(c) parent under section 527(f). All other payments made by a section 501(c) organization to its SSF for political use are treated as exempt function expenditures and are thus potentially taxable. These other payments have sometimes been informally known as made from “treasury funds” or “internal funds.”

The likely intent of the terminology in the Instructions is to distinguish funds promptly and directly transferred to an SSF from other funds held by the section 501(c) organization. However, without further definition, filing organizations may misconstrue the terms used as suggesting a distinction between their “own” funds and earmarked funds received from third parties or funds received by the section 501(c) organization from outside sources. A filer not intimately familiar with those Regulations or the intent underlying this distinction could conclude that various forms of funds provided by others are not its “own” “internal” funds.

³⁵ See Reg. § 1.527-6(e).

We recommend that the Service clarify the Instructions to eliminate this potential source of confusion. The Instructions could be clarified, very simply, by inserting, at the end of the “Note,” the following: “All other funds held by the organization that are expended or transferred to other organizations for section 527 exempt function activities should be reported, as explained in the instructions below, on Lines 1 or 2.”

b. Exclusion of amounts which are not subject to section 527(f)

Lines 1 and 2 are added on line 3 of Part I-C of Schedule C to produce an amount of taxable political expenditures which is to also be entered on Form 1120-POL. However, the Instructions for lines 1 and 2 do not clearly indicate that certain amounts which are not subject to tax as “exempt function expenditures” should not be included.

In order to avoid the entry of erroneous amounts on line 17b of Form 1120-POL, we recommend that the Instructions direct filing organizations not to include on lines 1 and 2 expenditures that are not subject to taxation under section 527(f). We recommend amending the Instructions to line 1 to read:

Enter the amount that the organization expended directly for section 527 exempt function activities. Do not include amounts paid or incurred for the indirect costs of maintaining a separate segregated fund, or expenditures for certain communications permitted under the Federal Election Campaign Act or similar state laws. Refer to Regulations section 1.527-6(b) for further information on expenses to include as exempt function expenditures.

Similarly, we suggest that the Service consider modifying the instructions to line 2 to read as follows: “Enter the amount of funds that the organization transferred to other organizations, including a separate segregated section 527(f)(3) fund created by the organization (except as explained in the Note above), for section 527 exempt function purposes.”

c. Line 5

The Instructions for line 5 require the organization to itemize payments of any amount to any section 527 organization, apparently for any purpose.

Requiring the disclosure of *all* payments to section 527 organizations creates a potentially huge burden and increases the likelihood of inadvertent noncompliance. We urge the Service to consider limiting the information disclosed here to voluntary payments that are not part of a quid pro quo exchange or other business transaction, and not to require disclosure of amounts below the disclosure threshold for disbursements by section 527 organizations reporting on the Form 8872. We suggest that the Service consider revising the Instructions to line 5 to read as follows:

Line 5. State the name, address and Employer Identification Number (EIN) of each section 527 political organization to which gifts, grants, contributions, or other voluntary payments aggregating \$500 or more were made. Do not include amounts paid as part of a bargained-for exchange or other business transaction. Enter the amount paid and indicate in column (e) if it consisted of political contributions or dues received and promptly and directly delivered to a section

527 political organization, such as a separate segregated fund or a political action committee (“PAC”). If additional space is needed, provide information in Part IV of this Schedule.

7. *Part II-A Lobbying Activity*

a. Lines 1a and 1b

The Instructions for lines 1a and 1b of Part II-A of Schedule C provide guidance for reporting the amounts of “grassroots lobbying” and “direct lobbying.” Organizations are directed to report the amounts expended from their “own funds” for such communications.

The phrase “its own funds” is problematic for the reasons set forth in these Comments with respect to the Instructions for Part I-C of Schedule C. Indeed, the terminology may be even more confusing to organizations attempting to complete Part II-A. In Part I-C, there is a distinction being made between the organization’s expenditures attributable to it, and the transfer of money directly and promptly to another organization, which is not treated as an expenditure by the transferring organization. No such distinction is relevant in the context of public charities reporting their lobbying activity.

The use of the phrase “its own funds” in the Instructions for Part II-A suggests that there are some other funds the organization might have and spend that would not be reported. Filing organizations might construe this as meaning that loan proceeds spent on lobbying are not reported, for instance. They also could easily think that they do not need to report expenditures from a segregated account maintained to support a specific project. It is easy for organizations to consider restricted funds, such as funds restricted by donors for a particular project, as not “our own” because they have been designated for a specific purpose. Deleting the unnecessary phrase “its own” from the Instructions to lines 1a and 1b of Part II-A will eliminate this potential confusion.

b. Line 2

The Instructions for line 2 provide directions for completing the calculation of any excess lobbying expenditures. Before the Instructions for specific lines, the Instructions provide general information regarding the table of lobbying expenses for the organization’s current taxable year and the three prior years.

We suggest that the Service modify item 3 in the numbered list. Item 3 provides guidance to organizations that first made the election under section 501(h) in 2008. However, item 3 suggests that such organizations must complete the schedule for the three prior years, as well as 2008. Because item 3 is addressing organizations which first made the lobbying election effective for 2008, the reference at the end of the first sentence should be to “line 2a, columns (d) and (e)” in order to require completion of information for 2008 and not prior years.

8. *Part II-B Lobbying Activity*

a. Section 501(h) election

The first paragraph of the Instructions for Part II-B indicates that organizations which engage in lobbying activities during the current year must complete Part II-B if “they did not make a section 501(h) lobbying election for that year by filing Form 5768.” As written, the Instructions may be interpreted by some organizations to mean that the Form 5768 must be filed for each year in order to be effective.

We recommend that the Service consider clarifying the language of this paragraph by rewording the first sentence as follows: “Part II-B provides a reporting format for any section 501(c)(3) organization that engaged in lobbying activities in its 2008 tax year but that did not have in effect a section 501(h) lobbying expenditure election for that year.”

b. Examples of potential lobbying activities

The Instructions on page 12 provide a bulleted list of activities constituting “attempting to influence legislation.” However, the list includes activities which may not be lobbying in some cases.

To avoid potential confusion, we recommend that the Service consider changing the language before the list to read:

Organizations should answer “Yes” or “No” in column (a) to questions 1a through 1i. Describe in Part IV of this Schedule the activities the organization conducted (either through its employees or volunteers) attempting to influence legislation. Examples of activities that should be reported include attempts to influence legislation in any of the following ways:

c. Overlap of lines 1h and 1i

The categories of activities listed on Schedule C, Part II-B, lines 1h and 1i, appear to be potentially overlapping. Line 1h includes efforts to influence legislation by “any other means,” while line 1i calls for efforts to influence legislation through “other activities.”

The Instructions for these lines suggest that line 1h is intended to describe communications made in public forums. It would be helpful if, in the future, this line of Schedule C could be changed to read, “Public forums such as rallies, demonstrations, seminars, conventions, speeches, or lectures.” However, for 2008, it would help for the Instructions to be more explicit. We recommend that the Service consider modifying the Instructions to state that the filer should report on Line 1h only lobbying activities carried out at public forums such as those listed, and list “other activities” on line 1i (and describe such activity in Part IV).

d. “Internal funds”

Lines 1f and 1h of the Instructions again use the unfortunate phrase “the organization’s own internal funds.” This terminology raises similar concerns to those raised above in these

Comments regarding Parts II-B and I-C. We recommend that the Service consider deleting this phrase so that the instructions to Lines 1f and 1h read as follows:

Line 1f. Grants to other organizations are amounts given by the reporting organization to another organization for the purpose of assisting the other organization to conduct lobbying activities.

Line 1h. Report on Line 1h attempts to influence legislation through public forums, which include but are not limited to rallies, demonstrations, seminars, conventions, speeches, and lectures conducted directly by the organization or paid for by the organization.

e. Failure to continue to qualify as a section 501(c)(3) organization

Line 2a of Part II-B of Schedule C requires an organization to indicate whether the various lobbying activities reported on line 1 cause the organization “to be not described in section 501(c)(3).” The Schedule C Instructions for line 2a direct organizations to give a “yes” answer if the lobbying activities reported on line 1j were “substantial,” but otherwise provide no guidance as to how organizations are to make such a determination.

In order to qualify for federal income tax exemption as a section 501(c)(3) organization, an organization must establish that “no substantial part of the overall activities of [the organization consist of] . . . carrying on propaganda, or otherwise attempting, to influence legislation. . . .” Section 501(c)(3) and the Regulations thereunder³⁶ provide little guidance about how much activity constitutes a “substantial part” of an organization’s “overall activities,” or about what activities must be measured.

The test for determining whether an organization’s lobbying activities constitute a “substantial part” of its “overall activities” is vague. The Service has provided very little guidance, and the court decisions in this regard do not present a uniform standard.³⁷ At the same time, the consequences for a non-electing organization of engaging in “substantial” lobbying are severe. This combination of extreme uncertainty and grave risk places the filing organization in the position of having to guess whether the Service would, under all of the relevant facts and circumstances, consider the organization’s lobbying activities to constitute a “substantial part” of its “overall activities.”

If an organization answered “yes” to the question in Line 2a, it would be stating a legal conclusion and admission that it violated one of the conditions for maintaining its tax-exempt status, regardless of whether it owed and paid tax under section 4912. Consequently, most

³⁶ Reg. §§ 1.501(c)(3)-1(b)(3), -1(c)(3)(ii).

³⁷ See, e.g., *Haswell v. United States*, 500 F.2d 1133, 1142 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975); *Christian Echoes Nat’l Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973); *Kuper v. Comm’r*, 332 F.2d 562 (3d Cir.), *cert. denied*, 379 U.S. 920 (1964); *Dulles v. Johnson*, 273 F.2d 362, 367 (2d Cir. 1959), *cert. denied*, 364 U.S. 834 (1960); *League of Women Voters v. United States*, 180 F. Supp. 379, 383 (Ct. Cl.), *cert. denied*, 364 U.S. 822 (1960); *Krohn v. United States*, 246 F. Supp. 341, 347 (D. Colo. 1965); GCM 34798 (Mar. 2, 1972); see also GCM 36148 (Jan. 28, 1975).

organizations will answer “no” if they have a reasonable basis for believing that their lobbying activity was “insubstantial.” However, if the Service later determines that the organization did engage in excessive lobbying and is no longer described in section 501(c)(3), the Service may also assert that the organization made a false statement on its return.

Until the Service issues comprehensive guidance that describes the meaning of “substantial” in this context, we believe that organizations should not be expected to determine on their own whether they have engaged in substantial lobbying activities. A non-electing organization that is uncertain about the extent of its lobbying should not be forced to choose between making a potentially false statement on its return or making an admission that it is not entitled to exemption. We therefore recommend that, as it has in the past, the Service confine the organization’s tax return reporting to “just the facts” about the nature and cost of the activity. Questions as to whether the activity was truly lobbying and, if so, whether it was substantial, can be resolved in the context of returns selected for examination.

Accordingly, we recommend amending the Instructions to clarify that the organization must check “yes” only if it was *notified by the Service* that its lobbying activities caused it to be not described in section 501(c)(3).

f. Lines 2b and 2c

Lines 2b and 2c of Schedule C require organizations to report the amount of tax “incurred” under section 4912 as a result of the organization ceasing to be described in section 501(c)(3). The Schedule C Instructions for these lines, however, ask for the reporting of the amount “imposed.”

Most organizations are likely to read the terminology of the Instructions as calling for the reporting of the amount of taxes under section 4912 that have been asserted or otherwise finally determined as a result of some action of the Service. In our view, we believe this is appropriate because, as noted above, we believe that line 2a should require reporting only by organizations which have received a determination from the Service that they are not described in section 501(c)(3) because of substantial lobbying activity.

As indicated by our Comments above in connection with Part I-B, we suggest that the Service modify the Instructions to be very explicit about the amounts that should be reported. However the Service ultimately resolves the Instructions for line 2a, we recommend that the Service make clear whether lines 2b and 2c are intended for reporting only taxes for activities conducted in 2008, or instead include amounts imposed and paid in 2008 for prior year activities.

9. *Part III – Section 6033(e) Notice and Reporting Requirements and Proxy Tax*

The Schedule C Instructions for Part III-A indicate that organizations which do not receive dues in excess of certain minimum amounts need not complete the proxy tax calculation in Part III-B. However, the Instructions currently do not include the amount. We suggest that the Service include the current dollar amount, which is \$97 for 2008, and annually update the Instructions to reflect the inflation adjusted amount.³⁸ Alternatively, if the Service does not wish

³⁸ Rev. Proc. 2007-66, 2007-45 I.R.B. 970; Rev. Proc. 1998-19, 1998-1 C.B. 547.

to create a need for annual updating of amounts, we recommend that the Instructions contain a reference to the appropriate Revenue Procedures.³⁹

D. Schedule D

1. General Comments

The Instructions to Schedule D reference various accounting standards, such as SFAS 117, SFAS 116, FASB EITF 02-7, and FIN 48.⁴⁰ The Instructions appear to assume that organizations will have some familiarity with such standards in order to properly prepare Form 990 and Schedule D.

The exposure to accounting standards should not be an issue for an organization which has retained accounting professionals and prepares audited financial statements. Many organizations, however, and particularly smaller organizations, will not have audited financial statements and, accordingly, will not have ready access to the accounting standards cited in the Instructions.

We suggest that the Service provide in the Instructions a copy of sufficient excerpts from the relevant accounting standards or provide an Internet reference or other source so that smaller organizations will have ready access to the necessary accounting standards. In addition, we encourage the Service to consider continuing to expand the eligibility requirements for filing the Form 990-EZ so that significant numbers of smaller organizations that may not have audited financial statements will be eligible to prepare the Form 990-EZ to avoid the cost of engaging a professional familiar with the accounting standards required to prepare the redesigned Form 990 return.

2. Part I Organizations Maintaining Donor Advised Funds or Other Similar Funds or Accounts

a. Column (b)

On Schedule D, Part I, column (b), the organization is required to report separate funds or accounts “held by the organization,” other than donor advised funds, where donors have the right to provide advice on the distribution or investment of amounts held in such funds or accounts. The Instructions do not provide any examples of such funds, nor provide significant direction as to the sorts of arrangements the Service is seeking to uncover. The Glossary likewise defines

³⁹ *Id.*

⁴⁰ Financial Statements of Not-for-Profit Organizations, Statement of Fin. Accounting Standards No. 117 (Fin. Accounting Standards Bd., 1993), available at http://www.fasb.org/pdf/aop_FAS117.pdf; Accounting for Contributions Received and Contributions Made, Statement of Fin. Accounting Standards No. 116 (Fin. Accounting Standards Bd., 1993), available at http://www.fasb.org/pdf/aop_FAS116.pdf; Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets, EITF Abstract 02-7, Ex. 1 (Fin. Accounting Standards Bd., 2002), available at <http://www.fasb.org/pdf/abs02-7.pdf>; Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, FASB Interpretation No. 48 (Fin. Accounting Standards Bd., 2006), available at http://www.fasb.org/pdf/aop_FIN48.pdf.

“donor advised funds,” but does not provide further guidance as to what “other accounts” the Service wants to be reported on Schedule D.

The category of "other accounts" is so broad that trust funds, escrow funds, deposits or custodial arrangements could be considered to be within this category. For example, a separate trust for which the organization and a donor are co-trustees might be included. We suggest that the Service explain in the Instructions what sort of accounts should be reported (presumably, the Service is seeking information regarding what are often referred to as “donor directed funds”) and provide examples in order to clarify the reporting requirements and avoid potential ambiguity.

b. Line 4

The Instructions for line 4 of Part I require the organization to report the aggregate value of donor advised funds, and the aggregate value of other funds, in column (a) and column (b), respectively.

It would be helpful to organizations to reinforce that these assets should also be reported somewhere on the organization’s balance sheet. We accordingly suggest that the Service consider adding the phrase "as reported on Form 990, Part X" to identify the value to be used in completing the columns.

3. *Part II Conservation Easements*

On Schedule D, Part II, line 6, the organization is supposed to report the number of staff or volunteer hours devoted to enforcing conservation easements during the year. However, it is unclear where this entry is to be entered on Schedule D.

If the formatting of Schedule D cannot be corrected to provide a space for entry of the requested hours, we suggest that the Instructions provide guidance as to where the hours should be listed.

4. *Part V Endowment Funds*

a. Permanent or “true” endowment

Under the Uniform Management of Institutional Funds Act (“UMIFA” or the "Act"),⁴¹ endowments are funds that are maintained to provide a source of income with the stipulation that the principal will be invested to generate income to be used by the organization. Under the Act, two general principles are applied: (1) assets should be invested prudently in diversified investments that seek growth as well as income, and (2) appreciation in value of the assets can be prudently spent by the charitable institution.

The Instructions define a "permanent (true) endowment" as an endowment fund that is maintained to provide a permanent source of income with the stipulation that the principal must

⁴¹ Unif. Mgmt. of Institutional Funds Act § 2 (1972).

be invested and kept intact in perpetuity, while only the income generated can be used by the organization. This definition of a permanent (true) endowment follows, to a certain extent, the definition of an endowment provided in the Act, except that under the Act, income could include appreciation in value of the assets. Thus, at a minimum, we believe that the Instructions require some clarification to the definition of permanent (true) endowment in order to reflect UMIFA.

In July 2006, the National Conference of Commissioners on Uniform State Laws approved the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and recommended it for enactment by the state legislatures.⁴² UPMIFA made many significant changes to the concept of "endowment" under the Act. The Act affirmed the concept of total return and expenditures of endowment assets for charitable program purposes, permitted prudent expenditures of both appreciation and income, and replaced the old trust law concept that only income (e.g., interest and dividends) could be spent. Thus, the old rule provided that asset growth and income could be appropriated for program purposes as long as the fund did not fall below historical dollar values. UPMIFA eliminates the concept of historical dollar value. UPMIFA states that the institution may instead appropriate for expenditure or accumulate so much of the endowment fund as the institution determines to be prudent for uses, benefits, purposes and durations for which the endowment fund is established.

Under UPMIFA, seven criteria guide an institution in its yearly expenditure decisions under UPMIFA: (1) duration and preservation of endowment, (2) the purposes of the institution's endowment fund, (3) general economic conditions, (4) effect of inflation or deflation, (5) expected total return from income and appreciation of investments, (6) other resources of the institution, and (7) the investment policy of the institution.

UPMIFA also includes an optional provision that allows states to enact another safeguard against excessive expenditures. If a state does not want to rely solely upon the rule of prudence set forth above, then a state may adopt a provision that creates a rebuttable presumption of imprudence if an institution spends an amount greater than seven percent of the fair market value of the fund calculated in an averaging formula over three years.

UPMIFA changes the definition of an endowment. In states adopting UPMIFA, potentially the entire funds held in the endowment would be subject to expenditure within the discretion of the institution. Further, a proposed FAS 117-a is under study to provide accounting standard guidance caused by the adoption of UPMIFA.⁴³

If the Service requires financial information regarding endowments, then the definitions of endowment need to be updated to reflect the flexibility provided for in UPMIFA, as well as the fact that organizations may be subject to different rules based on whether the state or states in which they operate have adopted UPMIFA. Accordingly, we suggest that the Service consider

⁴² Unif. Prudent Mgmt. of Institutional Funds Act (2006).

⁴³ Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures, Proposed FASB Staff Position No. 117-a (Fin. Accounting Standards Bd., 2008), *available at* http://www.fasb.org/fasb_staff_positions/prop_fsp_fas117-a.pdf.

modification of the “true endowment” definition in the Schedule D Instructions to reflect the varying possible approaches under state law.

b. Board designated or quasi-endowments

Line 2a of Part V of Schedule D requires organizations to report the percentage of its endowment funds (reported on the various parts of line 1 of Part V of Schedule D) represented by “[b]oard designated or quasi-endowment, [p]ermanent endowment,” and “[t]erm endowment.” The balance sheet of the Core Form (Part X, lines 27-29), however, categorizes the net assets of organizations as unrestricted, temporarily restricted, or permanently restricted. The Instructions for Part X of the Core Form state that “[a]ll funds without donor-imposed restrictions must be classified as unrestricted, regardless of the existence of any board designations or appropriations.”

The Instructions for Schedule D provide that board designated or quasi-endowments are funds functioning as an endowment but that are established by the organization itself, either from donor or institutional funds, “and that must retain the purposes and intent as specified by the donor or the source of the original funds.” This definition could be interpreted to mean that *only* board designed funds that were restricted in some manner by a donor can be classified as “board designated or quasi-endowment.” Organizations so interpreting the Instructions might also properly conclude that, because the Core Form Instructions clearly require the treatment of net assets restricted only by board action as “unrestricted net assets,” board designated endowment funds are not to be included in Schedule D reporting, notwithstanding the language of Schedule D itself.

In substance, board designated funds can be designated from *any* funds of the organization, including those that are unrestricted. Accordingly, we suggest that the Service modify the definition of quasi-endowments to provide that such endowment consists of “funds functioning as an endowment which are established by the organization itself, either from donor or institutional funds.” In addition, the Schedule D Instructions should clarify that such funds are to be reported on Schedule D, Part V, notwithstanding that such funds will be reported as “unrestricted” on the balance sheet of the Core Form.⁴⁴

c. Lines 3a(i) and (ii)

Line 3(a) of Part V inquires if other endowment funds are held in the possession of unrelated organizations or related organizations. The Instructions do not require any further elaboration upon this information.

If endowment funds are held by a related organization, then the related organization should be listed in Schedule R. If there are endowments held by unrelated organizations, we recommend that the Instructions be modified to require a disclosure in Part XIV of Schedule D as to the identity of the unrelated organizations. Contributors to an organization should be aware

⁴⁴ Alternatively, for future years, the Service may wish to consider eliminating the “board designated or quasi-endowment category from Part V of Schedule D, since the inconsistency of the reporting between the Core Form balance sheet and Schedule D may create confusion instead of transparency.

that there are endowment funds that are held by unrelated organizations which may or may not be on the balance sheet of the organization. Such information could be important to a potential donor of the organization, as well as various state regulatory agencies.

d. Line 4

Line 4 of Part V requires the organization to describe in Part XIV the intended uses of its endowment funds. The Instructions provide no additional guidance, simply repeating the direction from Schedule D.

Organizations with significant endowments could have multiple intended uses of their endowment funds by reason of the fact that donors have placed restrictions on the expenditure of endowed funds. Presumably, all the uses of the organization's endowed funds are for the benefit of the organization.

We doubt whether listing a large number of restrictions for multiple restricted endowment funds serves a purpose to the reader of the Form 990 or the Service. One alternative would be to identify the "primary" uses of the endowment, but not more than three or some limited number of broad categories. For example, a college or university might list endowment purposes as "scholarships, departmental support, or general support," even though such categories might cover numerous student scholarship funds, endowed chairs, and other special purpose funds.

The absence of some clarification in the Instructions with respect to this disclosure could result in an unduly long list of intended uses of the endowment funds containing multiple restrictions created by various donors. A long-established college or university with hundreds and hundreds of endowments could, for example, have a list running many, many pages. We suggest that the Service consider clarifying the Instructions to identify with more specificity the information requested.

5. *Part VII Investments—Other Securities*

a. Inconsistency between Core Form and Schedule D

The Instructions with respect to the Core Form and Schedule D appear to be inconsistent with respect to whether Part VII of Schedule D needs to be completed.

Part X, line 12, of the Core Form provides that if an amount is reported on line 12, then the organization should complete Part VII of Schedule D. The amount reported on line 12, column B of Part X must be equal to the total of Part VII, column (b) of Schedule D.

The Instructions to Schedule D, however, provide that an organization must complete Part VII of Schedule D if the organization answered "yes" to Part IV, line 11, of the Core Form, *and* reported an amount on the Core Form balance sheet (Part X, line 12), that is five percent or more of the organization's total assets reported on line 16 of the Core Form balance sheet (Part X).

Because both Part IV, line 11, and Part X, line 12, of the Core Form seem to direct organizations to complete Part VII of Schedule D without regard to any limitation on the amount reported, organizations may miss the direction in the Schedule D Instructions to complete Part VII only if the five percent reporting limitation is exceeded. Accordingly, we suggest that the Service consider including a reference to this limitation as part of the Instructions for the Core Form, Part X, line 16. It may also be helpful to readers of the Instructions to similarly reference the limitation in the Instructions for the Core Form, Part IV, line 11, which direct organizations to complete Part VII of Schedule D if they have investments in “other securities.”

b. Elaboration on types of investments

The Instructions for Part VII indicate that “other securities” include closely held stock and publicly traded stock if the organization owns more than five percent of the outstanding shares of that class. The Instructions do not provide guidance as to whether other common types of investments, such as interests in hedge funds, financial derivatives, partnerships, or limited liability companies, are to be treated as “other securities” reported on Part VII (or perhaps “other assets” reported in Part IX).

Organizations with sophisticated investment programs commonly hold investments in partnerships and limited liability companies for the purpose of prudent diversification of their investment portfolios. We suggest that the Service consider modifying the Instructions to indicate that such investments should be reported on Part VII. Also, we recommend (1) that the Instructions clearly state that a listing of individual securities is not required and securities only must be listed by asset class, and (2) that the Instructions state that reporting of the underlying investments held by the pass-through entity is not required.

6. *Part VIII Investments—Program Related Investments*

a. Investment “type”

Column (a) of Schedule D, and the Instructions for column (a), state that organizations are required to list each “type” of program related investment. However, the Instructions for column (b) require the organization to list the book value of “each” program related investment.

As the Instructions are currently written, a reader might conclude that each student loan, for example, should be listed because of the directive in the Instructions to list the book value of “each” investment. In order to make clear that Part VIII is seeking only values for each “type” of investment, and not lengthy schedules of individual student loans or other investments, we suggest the Service add a statement to the Instructions that only the categories of the program related investments are to be provided, not specific investments, such as student loans.

b. Inconsistency between Core Form and Schedule D

The Instructions to the balance sheet of the Core Form (Part X) for program related investments provide that if an amount is reported on line 13, then the organization must complete Part VIII of Schedule D. The instructions to Part VIII of Schedule D, however, provide that if the organization answered “yes” to Part IV, Line 11, of the Core Form, and reported an amount on line 13 of the Core Form balance sheet (Part X) that is five percent or more of the total assets

reported on Part X, line 16, then the organization is required to complete Part VIII of Schedule D.

We suggest that the Service consider modifying the instructions to the Part X of the Core Form to clearly indicate that Part VIII of Schedule D must be completed *only* if the aggregate program related investments reported on line 13 exceeds more than five percent of the total assets of the organization. Otherwise, many organizations are likely to overlook the more specific directions in the Schedule D Instructions and complete Part VIII of Schedule D when it is not required.

7. *Part IX Other Assets*

a. Inconsistency between Core Form and Schedule D

The Instructions to line 15 of the balance sheet of the Core Form (Part X) require the organization to complete of Part IX of Schedule D if “other assets” are reported on Part X, line 15. However, as noted in these Comments with respect to the comparable Instructions for program related investments and other securities, the Instructions to Part IX of Schedule D require completion of Schedule D only if the other assets amount reported on line 15 of the Core Form balance sheet exceeds five percent or more of the total assets reported on line 16 of the Core Form balance sheet (Part X).

We suggest that the Service consider modifying the instructions to the Part X of the Core Form to clearly indicate that Part IX of Schedule D must be completed *only* if the aggregate other assets reported on line 15 exceeds more than five percent of the total assets of the organization. Otherwise, many organizations are likely to overlook the more specific directions in the Schedule D Instructions and complete Part IX of Schedule D when it is not required.

b. Asset classification

The Instructions provide that an organization may use “any reasonable basis” for classification by type of its “other assets,” as opposed to listing individual assets.

As discussed above in these Comments, the separation of the “other securities” and “other assets” is not altogether clear. We suggest that the Service consider providing examples in the Instructions as to the sort of classifications and asset categories that would be appropriate for Schedule D.

8. *Part XIV Supplemental Information*

Part XIV contains considerable space. However, the Instructions for Schedule D require elaboration in Part XIV for a number of items. Taking into consideration the space limitations normally imposed by electronic filing, it is possible that some organizations will not have sufficient space to provide all required explanations on Part XIV.

We suggest that the Service provide direction, in the Instructions for Part XIV, as to what filing organizations are to do if the space provided in Part XIV proves to be insufficient to provide all of the required information.

E. Schedule E

We do not have any comments with respect to Schedule E.

F. Schedule F

1. General Comments

a. Foreign organizations filing Form 990

Formation under foreign law does not preclude an organization from qualifying as an exempt organization under section 501(c)(3).⁴⁵ Organizations which so qualify and have obtained a determination letter from the Service recognizing their qualification are required to file Form 990, and generally do so listing their worldwide income.

The first page of the Instructions to Schedule F suggests that such foreign organizations must report all of their activities outside of the United States on Schedule F. The Instructions indicate that branch offices, accounts, and employees of the filing organization located outside of the United States are not treated as “foreign organizations,” but rather as part of the filing organization. The activity of maintaining employees outside of the United States includes “principal” offices.

We recommend that the Instructions for Schedule F, as well as the Core Form, be revised to clarify to what extent a foreign organization that has obtained a determination letter from the Service that it is exempt, and is filing a Form 990, is required to report its foreign activities and grants on both the Core Form and Schedule F. The following example highlights the need for clarification.

Example 1. Organization C is a college located in Europe. Organization C is described within the definition of a foreign organization provided in the Glossary. Organization C invests US \$500,000 of its €2 billion endowment in the United States. Organization C does not conduct any educational activities in the United States or have other income from United States sources, except the investment income noted.

Several decades ago Organization C filed for recognition of exemption, and was classified as a public charity under sections 509(a)(1) and 170(B)(1)(A)(ii), in order to invest in the United States without being subject to federal income taxation. Organization C has since annually filed Form 990.

In Example 1, one option would be for the Service to require Organization C to report on the Core Form only its investment income sourced in the United States, and to report on Schedule F the amount of income that is used towards program services in Europe. If this method of reporting were adopted, it would be possible for Schedule F to be used as a source of statistical information for policymakers as to the amount of income from sources within the

⁴⁵ Rev. Rul. 1966-177, 1966-1 C.B. 132.

United States, and charitable contributions, which are being used to fund exempt activities outside of the United States. This would also avoid the rather awkward fit, under the current Schedule F and Core Form, of reporting the principal administrative activities of a foreign organization on Schedule F, which is geared more towards reporting program service activities and grants outside of the United States.

The other option for the Service would be to require all of Organization C's worldwide income, expenses and activities which exist or occur outside of the United States to be reported on the Core Form (and the various schedules triggered by questions on the Core Form), and again on Schedule F. Thus, information would be reported including faculty and administrative compensation, donor identities, and scholarship recipients' identities.

We believe that the scope of the information solicited by Schedule F and the Core Form with respect to foreign organizations filing the Form 990 should be limited to information regarding the organization's foreign activities and grantmaking that are directly attributable United States-sourced income, as opposed to requiring a foreign organization to detail all of its core activities conducted outside of the United States under the laws of the country in which Organization C is created and regulated. Making the filing obligations of a foreign organization unduly burdensome in light of the relative amount of income that is received from activities in the United States will be a deterrent to foreign organizations considering obtaining a determination letter as to their exemption from the Service.

We recommend that the Service continue to encourage foreign organizations to act as "good citizens" and to apply for exemption and file the Form 990. Accordingly, we recommend that the Service consider modifying the Schedule F and Core Form Instructions to state that foreign organizations are only required to report their foreign activity on Schedule F to the extent that it is attributable to United States-sourced income.

b. Layout of Schedule F

The current layout of Schedule F may be confusing to filing organizations. Specifically, the heading to Part I inquires about *activities* outside of the United States, while the heading to Part II inquires about *grantmaking*. The heading for Part I speaking to *activities* is nonetheless immediately followed by two questions specifically for grantmakers (Part I, lines 1 and 2). Although it falls under the *activities* heading, the Specific Instructions for line 3 of Part I make it clear that this line requires disclosure of the total amounts of *grantmaking* by region, as well as other activities.

We suggest that the Service consider revising the Instructions to Schedule F to make it clear that even if the organization is a grantmaker only, and does not conduct other activities outside of the United States, the organization is still required to complete lines 1, 2 and 3 of Part I, in addition to completing Part II.

We also recommend the use of an example or two to clarify the requirements of Schedule F.

Example 2. Organization F is a "friends of" organization formed in the United States that makes \$2 million in grants to its foreign affiliates during its fiscal year

2008 but does not conduct other activities in foreign countries. Organization F is required to complete lines 1 and 2 of Part I, to complete line 3 of Part I to include the specific amounts of grants made to its foreign affiliates in each region in the table on line 3, and to denote that the activity in the region is “grantmaking” in column (d). Organization F must also complete Part II of Schedule F. Organization F will not be required on its Schedule F to report grants or expenditures later paid by its foreign affiliates.

Example 3. Organization P is a public charity organized in the United States that both makes grants to *foreign organizations* and conducts activities in foreign countries. Organization P is required to complete lines 1, 2, and 3 of Part I and will be required to include its activities, including grantmaking, in the table in line 3 of Part I. Organization P is also required to complete Part II of Schedule F.

2. *Part I General Information on Activities Outside the United States*

a. Lines 1 and 2

The Instructions to lines 1 and 2 in Part I indicate that organizations are to complete the lines regarding records and procedures for foreign grants *only if* they “make grants directly to foreign organizations, foreign governments, or foreign individuals. The Instructions also acknowledge that United States “friends of” organizations that support specified foreign organizations can describe their supervision of their foreign grants in part by indicating their status as “friends of” organizations.

Because “friends of” organizations are relatively common, we suggest that the Service consider revising the Instructions to lines 1 and 2 to address such organizations in detail. First, the Instructions might clarify that if the organization filing the Form 990 makes grants only to United States organizations that operate as “friends of” organizations, the filing organization does not need to complete lines 1 and 2 with respect to grants made to the United States “friends of” organization. In such cases, the grant will have been made to a United States organization, and that organization will determine whether and when grants may be paid to an affiliated *foreign organization*. The Instructions might also emphasize that the United States “friends of” organization will need to respond to lines 1 and 2 with respect to grants it pays to foreign grantees (including its affiliates).

The following example might be a useful addition to the Instructions to clarify this point.

Example 4. Organization P is a U.S. public charity described in sections 501(c)(3) and 509(a)(1). Organization P grants \$60,000 to a “friends of” organization formed in the United States, Organization F, which in turn pays three separate grants to its affiliated organizations in foreign countries A, B, and C. Organization P does not make grants to any *foreign organizations*. Organization F exercises control and discretion over the grants that it pays to its affiliates in foreign countries A, B, and C. Organization F’s affiliates in foreign countries A, B and C distribute the funds to various organizations and individuals internationally. Organization P is not required to complete Schedule F with

respect to the grant paid to Organization F. Organization F is required to complete Schedule F with respect to the grants it paid to its affiliates in foreign countries A, B, and C. Organization F, however, will not be required to complete Schedule F with respect to the grants made by its affiliates in foreign countries.

b. Line 3

Line 3 of Part I of Schedule F asks filing organizations to complete a table to describe their foreign activities on a regional basis, including listing the number of offices and employees, as well as detailing the types of activities and program services, and total regional expenditures. The Instructions do not specify any temporal requirements. As a result, the information required in the table may not be representative of the organization's full-year program activity.

If the Service intends for information to be provided as of the end of the taxable year, or some other specific date, we suggest that the Instructions be clarified to state the specific date. We note, however, that if information is provided as of a specific date, the numbers will provide a snapshot of only that one day.

For example, if year-end is chosen, international relief organizations may end up reporting information as of a day that falls outside of crisis periods, and would understate their activity levels in foreign countries. If instead the information sought by the Service is meant to describe activities over the course of the year (for example, total numbers in each location for the year), that should be stated and thought should be given to preventing double counting. In addition, perhaps there should be a minimum amount of time that an individual or the organization must spend in a given location before the organization is required to report the presence of the individual or organization in that location.

The following examples illustrate the complexity in determining how to instruct organizations to complete line 3.

Example 5. Assume that the Instructions specify that information is to be provided as of the last day of the fiscal year and that day is December 31. On June 1 there is a massive earthquake in China and international relief Organization I sends 30 employees to the region to provide aid. After 3 months in China, all 30 employees return to the United States and remain there for the rest of the year. As Organization I does not have any employees in China on December 31, Organization I will not report any activity in China, despite the fact that it had 30 employees located there for three months during the course of the year.

Example 6. Assume that the Instructions do not specify a specific date to report. If an organization sends Employee X to serve in foreign countries A, B and C throughout the course of the year, the organization might report Employee X three separate times in different locations and the numbers might not provide an accurate picture of the organization's activities overseas as Employee X is one individual who was deployed to three different foreign countries in addition to the United States.

Example 7. Assume that the Instructions do not specify a required duration to qualify as presence in a foreign country (other than the current reference in the Instructions to line 3, column (c), which directs organizations to disregard employees or agents whose sole purpose is to conduct “on-site visits,” which are not defined). If an international relief organization sends an employee into Foreign Country A for a three-day exploratory mission, but then ultimately does not provide any subsequent aid to Foreign Country A and does not return to Foreign Country A in that year, should the organization be required report its activity in Foreign Country A for that year?

We recommend that the Schedule F Instructions be revised to clarify the Service’s intentions in these situations. For example, if the goal of the Service is to obtain information as to the regions in which the organization concentrates its efforts, the Service might require the reporting of the maximum number of employees the organization had in a particular region at any time during the year, even if that will ultimately result in the reporting of a number which exceeds the total number of the organization’s employees. It is our understanding that international relief organizations generally track deployments by departure dates or missions undertaken, whether or not they are of a particular duration. The Schedule F, however, may not match the manner in which such data is reported in organizations’ annual reports.

3. *Part II Grants and Other Assistance to Organizations or Entities Outside the United States*

Line 1 of Part II consists of a table for reporting grants and other assistance to organizations outside of the United States. Grantees receiving more than \$5000 are to be reported on line 1, including information as to the region, purpose, amount, and manner of disbursement. Part II of Schedule F also contains columns for the name of the grantee organization and its “EIN (if applicable),” although these two columns are shaded for 2008.

The Highlights to the Instructions to Schedule F note that the information in Part II, line 1, columns (a) and (b) (requiring the name of the grantee organization and the IRS code section and EIN (if applicable) of the grantee organization) does not need to be provided in 2008. However, the Instructions do not provide any specific guidance as to future years.

We recommend that the Instructions be amended to clarify that the Service does not expect foreign organizations or governments to obtain determination letters from the Service or EINs on an ongoing basis. Because such a process would take considerable time, if the Service intends to require EINs of grantees in the future, this information should be put in the Instructions now so that organizations may begin to prepare for this requirement. In addition, if the Service ever requires organizations to complete the columns requiring the EIN and name of the grantee (which we do not recommend), we suggest that the Service amend the Instructions to clarify that only organizations that *have* a determination letter or an EIN are required to complete the column calling for such information.

G. Schedule G

1. Part I Fundraising Activities

a. Line 2a

Line 2a of Schedule G asks organizations whether they had a “written or oral agreement” with an individual or entity in connection with professional fundraising activities. The Instructions instruct organizations to respond “yes” if the organization during the year “had an agreement with another person or entity to perform fundraising activities.”

Organizations are often confused by terminology that suggests a formal legal relationship, even though one may have been created. Rather than conditioning an affirmative response on the existence of an “agreement,” we suggest that the Service consider modifying the Instructions (and Schedule G, either now or in future iterations) to require a “yes” response if “any individual or entity, for compensation, raised funds for the organization.”

b. Line 2b

Line 2b of Schedule G consists of a table for the listing of the organization’s ten highest paid professional fundraisers. Organizations are required to specify the nature of the fundraising activity conducted by each fundraiser in column (ii), and the amount paid to or retained by the professional fundraiser in column (v).

(i) Column (ii) activity

The Instructions for column (ii) simply direct the organization to enter the “type” of fundraising activity.

We suggest that the Service elaborate on the categories required. Examples, such as “direct mail” or “special event,” would be helpful. If the Service desires further detail, such as the type of event, examples so indicating would also be useful. For example, the Service might include “fundraising dinner, charity auction, or walkathon,” as illustrations of permissible responses.

(ii) Column (v) amounts paid to or retained by fundraiser

The Instructions direct organizations to list “fees paid to or fees withheld by the fundraiser for its professional fundraising services.” The Instructions also provide that organizations are to report expense reimbursements on Schedule O, and to explain how the organization distinguishes fees from expense reimbursements.

Although the Instructions imply that expense reimbursements are not to be reported in column (v), a direct statement of this direction would be helpful in the Instructions. We suggest that the Service modify the Instructions to state that organizations should “report expense reimbursements, which are not part of the fees paid to the fundraiser, on Schedule O, and detail how the organization distinguishes expense reimbursements from fees paid to compensate the fundraiser for its services.”

2. *Part II Events*

a. In general

Part II of Schedule G provides a list of fundraising events. The Instructions direct organizations to complete Part II only if it reported special event revenue (as distinguished from contributions relating to such events) on line 8a of the Core Form statement of revenue (Part VIII) of more than \$15,000. Individual events are to be listed only to the extent that they generate gross receipts of more than \$5000.

The Instructions do not provide guidance for organizations with special event revenue of more than \$15,000 but no one event meeting the more than \$5000 threshold. For example, an organization could have four events each generating \$4000 in gross receipts, and thus exceed the \$15,000 threshold, but not be required to list any events in Part II.

We suggest that the Service consider providing guidance to such organizations by stating that if no event exceeds \$5000, the organization should list “None over \$5000” in column (a) of Part II of Schedule G.

b. Column headings

Part II of Schedule G asks organization to list the “event name” for the organization’s two largest fundraising events. The Instructions instead ask for a listing of the “type of event.”

Organizations may be confused by the conflicting directions between Schedule G and the Instructions. We suggest that the Service consider modifying the Instructions to require organizations to list the largest two events by name and adding the following: “If the type of event (dinner, auction, concert, or otherwise) is not obvious from name, provide the type of event rather than the name.”

c. Line 5 (non-cash prizes)

Line 5 of Part II asks organizations to report the amount of prizes paid out in a form other than cash. The Instructions provide no guidance as to the calculation of the amount on this line, other than directing organizations to report the “fair market value.”

We recommend that the Service consider providing a reference to other parts of the Instructions where valuation of non-cash contributions is discussed in order to provide assistance to organizations in completing Part II.

In addition, guidance would also be helpful as to what the Service means by “prizes.” For example, it is common at fundraising dinners for organizations to provide some token item bearing the organization’s logo. Are these items (which generally are difficult to value and are the sorts of items which are, in some fundraising contexts, disregarded)⁴⁶ to be listed on line 5,

⁴⁶ In the context of a fundraising campaign in which the donee advises the donor of the amount of the payment by the donor which constitutes a deductible charitable contribution, certain low-cost articles may be disregarded because they provide only an “insubstantial value” to the donor. For 2008, if a donor contributes at least \$45.50, and the only benefit the donor receives is a “token” item bearing the logo of the organization and costing the

or instead to be included in the overall calculation of direct expenses of the dinner? We suggest that the Service clarify the Instructions to provide specific guidance as to the reporting of such common items.

3. *Part III Gaming*

a. Volunteer labor

Line 6 of Schedule G calls for organizations to indicate whether they use volunteer labor for gaming activities and to estimate the percentage of volunteer labor. The Instructions direct organizations to compute the percentage by comparing the number of volunteers and the number of individuals who “receive direct compensation for their services provided in the conduct of the gaming activity.”

We recommend that the Service consider expanding the Instructions to provide further guidance to organizations as to what percentage constitutes “substantially all” for purposes of the exclusion of gaming revenue from unrelated business income. Since this determination is critical to ascertaining whether the organization is required to report unrelated business taxable income from its gaming activity, it would be helpful to provide guidance to organizations where they are most likely to read it, in the Instructions for the particular line calling for information regarding volunteers.

We also suggest that the Service provide examples as to the treatment of employees of the organization who, as part of their duties, attend gaming fundraisers. For example, suppose that an organization which holds quarterly casino nights otherwise staffed exclusively by volunteers requires the salaried Executive Director of the organization to attend and personally thank the volunteers and to meet community members attending the events. The Executive Director is also required to attend all other major fundraising events conducted by the organization. The Instructions should indicate whether the employees in such situation should be counted in determining the volunteer percentage. We suggest that the Service consider providing in the Instructions that the participation of such employees, which accounts for at most a minimal amount of the duties of such employees for which they receive a regular salary, may be disregarded because the employees do not participate in the direct conduct of the gaming activity.

b. State licensure

Line 9 of Schedule G asks for information regarding whether the organization is “licensed” to conduct gaming activity in the states in which it does so. The Instructions do not significantly elaborate on this question.

Some states require a form of registration or other formal notice to conduct certain gaming activity, but this registration may not be viewed by organizations as constituting a

organization less than \$9.10, then the value of the item may be disregarded, and the payment by the donor is fully deductible as a charitable contribution. Rev. Proc. 1990-12, 1990-1 C.B. 471, *as amplified by* Rev. Proc. 1992-102, 1992-2 C.B. 579, *and modified by* Rev. Proc. 2007-66, 2007-45 I.R.B. 970, § 3.27(2).

license or permit. We suggest that the Service consider elaborating on the meaning of the term “license” by indicating in the Instructions that licensing includes registration or other compliance with the applicable legal requirements of the state in which the charity conducts the gaming activity.

c. Facilities for gaming

Line 13 of Schedule G asks organizations to indicate whether they conduct their gaming activities in the “organization’s facility,” or an “outside facility.” The Instructions provide no guidance with respect to line 13.

Some organizations may be confused as to whether a facility they lease, and which is used for other activities of the organization as well as occasional fundraising, including gaming, is their own facility. Similarly, a leased facility which the organization uses exclusively for gaming may not be viewed by the organization as an “outside” facility.

We recommend that the Service provide guidance in the Instructions as to the appropriate treatment of leased facilities. Otherwise, organizations are unlikely to provide consistent responses to line 13.

d. Gaming books

Line 14 of Schedule G asks for the identity and address of the individual who prepares the special events or gaming books of the organization. The Instructions do not provide any additional guidance with respect to line 14.

In the Core Form and other portions of Form 990 where information regarding the address of an individual is called for, the Instructions generally permit organizations to list the address of the organization if the individual can be reached at such address. We recommend that the Service consider adding guidance in the Instructions to line 14 indicating whether such a practice is acceptable for Schedule G.

H. Schedule H

1. *Highlights*

The Service requested comments on whether subsidized health services should include costs of conducting a physician clinic or skilled nursing facility. If so included, these costs would be reported on Part I, line 7g, of Schedule H.

Hospitals which operate physician clinics and skilled nursing facilities as part of their services to the community often also use those facilities to provide subsidized health services in a manner similar to hospital inpatient services. In addition, such services are similar to some of the services, such as “satellite clinics,” identified in the Instructions to Worksheet 6 as entering into the calculation of the amount of subsidized health services. Accordingly, we suggest that the Service consider including in the calculation of subsidized health services the costs of conducting physician clinics and skilled nursing facilities which meet an identified community need, provided that such activities are not self-sustaining.

2. *General Instructions*

a. Definition of “hospital”

A hospital required to complete Schedule H is defined in the Instructions as a facility which is or is required to be “licensed or certified as a hospital under state licensing or certification laws.”

Certain states “register” hospitals. In order to assure that such hospitals are not confused by the “licensing” language in the Instructions, we suggest that the Service consider modifying the Instructions to include hospitals which are “licensed, certified, or registered” as such under state laws.

b. Aggregation

The Instructions direct organizations to aggregate information from all hospitals operated by the organization, disregarded entities for which the organization serves as the sole member, or hospitals operated by members of a group for which a group return is filed. The Instructions further direct, in the fourth numbered item in the second paragraph of the “Purpose of Schedule” section, the aggregation of information from the “organization or any of the entities . . . , even if not provided by a hospital or provided separate from the hospital’s license.”

The language of the Instructions may be confusing to readers, since the referenced item does not clearly describe the information that is to be aggregated. The intention of the Instructions appears to be that all services provided by a hospital or other legal entity included in Schedule H are to be reported on Schedule H, even if the actual services were provided by a facility which is not itself a licensed hospital facility. We recommend that the Service consider modifying the provision to state that Schedule H is to include information from the organization and other entities, “even if the relevant services were not provided by a hospital or were provided separate from the hospital’s license.”

3. *Part I Charity Care and Certain Other Community Benefits at Cost*

a. Direct offsetting revenue

Line 7 of Schedule H is used for the calculation of certain costs of providing community benefits. Line 7 requires the listing of total expenses in column (c), “direct offsetting revenue” in column (d), and the calculation of the net of the two in column (e). The Instructions define “direct offsetting revenue” to include “any revenue generated by the activity or program, such as reimbursement for services provided to program patients.”

We recommend that the Service permit organizations to disregard de minimis amounts of revenue, such as revenue from small patient payments. The Instructions already permit the exclusion of grants or contributions from “offsetting revenue.” Small patient payments are analogous, often provided voluntarily or to encourage the appropriate patient recognition of the value of the services.

b. Reporting of gross expense percentages

The Instructions provide a “NOTE” at the top of page 7 indicating that organizations may choose to report certain gross expenses of providing community benefits as a percentage of the organization’s total expenses. This additional information is to be provided as supplementary information in Part VI of Schedule H, rather than in the table provided for line 7 of Part I.

The NOTE suggests that such expenses may be found in column (d). We believe the intended reference is to column (c).

c. Documentation in lieu of worksheets

The Instructions provide Worksheets 1 through 8 to assist organizations in completing the table in line 7 of Part I. The Instructions go on to state that the worksheets are not required, and should not be filed with the Form 990; organizations which do not use the worksheets are to maintain “equivalent” documentation.

We suggest that the Service consider permitting organizations to maintain “comparable” documentation. If the intent of the Service is to provide flexibility to hospitals in their recordkeeping, “comparable” is more likely to be interpreted by organizations as providing such flexibility.

d. Health professions education (line 7f and Worksheet 5)

Line 7f provides for the reporting of costs of health professions education as part of line 7’s calculation of “other community benefits at cost.” Worksheet 5 provides that costs related to nursing education and continuing medical education are not includable in this calculation if the educational programs are restricted to hospital medical staff members, or if nursing students are required to become employees of the hospital for some period of time after graduation.

We suggest that the Service consider modifying the Instructions to include costs of continuing medical education and nursing education in the calculation of “other community benefits” *if* the education is provided pursuant to a community needs assessment and the recipients of the education are not precluded by non-competition or other agreements from performing services for other health care providers.

Many communities are served by only one hospital. Hospitals in such communities providing continuing medical education to their medical staff are indeed providing education to all qualified physicians in the community, and the costs should be treated as part of “other community benefits.”

Moreover, health professionals often practice in more than one setting. For example, the nurse trained at a hospital may well also work at an extended care facility. Physicians may be on the medical staff at multiple hospitals, or may work on call for various facilities, so long as they are not prevented from doing so by non-competition agreements. Although education provided for medical staff or nurses at a particular hospital undoubtedly provides some benefit to the hospital where such individuals practice, it also benefits the community as well, by enhancing the ability of such individuals to practice in other settings. Education is a benefit to the

community as a whole, even if its predominant purpose is to provide the individual with skills that assist in practicing a particular trade or profession, even for a particular employer.⁴⁷ Unless the individual is prohibited for working for any other health care provider other than the provider offering the education, we recommend that the Service permit the inclusion of the costs of such education in the calculation of “other community benefit.”

In addition, certain parts of the Instructions appear to be inconsistent with respect to the amounts to be reported for costs of providing continuing medical education. The Instructions for Worksheet 5 (at page 21) provide that if continuing medical education courses are “open to all qualified individuals in the community,” the hospital is to include the salaries and fringe benefits of faculty members teaching such courses in costs treated as “other community benefits” if such courses qualify for continuing health professions education credits.

However, the chart on page 20 of the Instructions suggests that such costs are to be reported “only to the extent provided to doctors not on the hospital’s own medical staff.” The chart appears to be inconsistent with the direction provided on the following page, and, if our suggestion above in these Comments is not adopted to broaden the continuing medical education costs includable in the other community benefit calculation, we nonetheless suggest that the Service consider modifying the language of the chart to allow reporting of such costs “only if open to all qualified individuals in the community” in order to eliminate the apparent inconsistency in the Instructions.

e. Contributions to community groups (line 7i and Worksheet 8)

Line 7i includes in the calculation of “other community benefits” cash and in-kind contributions by the organization to community groups and other health care organizations that are restricted to providing “community benefit” activities of the sort reported on the other parts of line 7. The Instructions provide, however, that the organization should not include “any contributions that were funded in whole or in part by a restricted grant, to the extent that such grant was funded by a related organization.”

We suggest that the Service consider deleting this provision of the Instructions. Many health care organizations maintain a separate fundraising foundation to provide funds for the support of the various activities of the hospitals and other health care service providers that are part of a health care system. It is unclear why restricted grants from such an entity, and from no others, should call for different treatment.

4. *Part II Community Building Activities*

Part II of Schedule H provides for the reporting (optional for 2008) of various activities for the improvement of the community in which a hospital is located. Line 8 of Part II calls for the reporting of “workforce development,” defined in the Instructions as including, “recruitment of physicians and other health professionals to medical shortage areas or other areas designated as underserved.”

⁴⁷ See, e.g., Rev. Rul. 1972-101, 1972-1 C.B. 144; Rev. Rul. 1968-504, 1968-2 C.B. 211; Rev. Rul. 1965-298, 1965-2 C.B. 163.

The language of the Instructions may be read by some to require some form of governmental or other agency designation of the geographic area in which the hospital is located as “underserved” in order to report “workforce development” costs on line 8. However, in the past, the Service has permitted hospitals to offer recruitment incentives for particular types of physicians if the hospital has “objective evidence demonstrating a need” for such physicians in the community.⁴⁸

We recommend that the Service consider revising the language of the Instructions to include “recruitment of physicians and other health professionals to areas where there is objective evidence demonstrating a need for such individuals.”

5. *Part III Bad Debt, Medicare, & Collection Practices*

The Instructions for Line 8 (at page 11), relating to Medicare shortfall amounts, appear to contain a typographical error. In the sixth line, the reference to “expenses” presumably should be “expenses.”

6. *Part IV Management Companies and Joint Ventures*

Part IV calls for the reporting of certain joint ventures or management companies in which the organization has an interest.

The Instructions direct organizations to list joint ventures or other entities in which the organization is a partner or shareholder, and management companies in “which current officers, directors, trustees or key employees of the organization, and physicians who have staff privileges with one or more of the organization’s hospitals” own more than a ten percent stock or profits interest, and which provide management services or other property or services used by the organization to provide medical care. The Instructions list ancillary joint ventures between hospitals and physicians as one of the examples of arrangements to be reported in Part IV.

The Instructions may be read by some as calling for the reporting of joint ventures irrespective of whether there is any physician or officer ownership, since the requirement of ten percent officer, director, key employee, or physician ownership appears to relate only to management companies. The ancillary joint venture example suggests that this was not the Service’s intent, and we accordingly recommend that the Service clarify the Instructions to so indicate, perhaps by adding a comma after the phrase “or any management company” in the second line of the Instructions for Part IV.

In addition, the first and second paragraphs of the Instructions for Part IV use different terminology in describing the physician ownership which must be counted in calculating whether the ten percent ownership requirement is met. As noted above, the first paragraph refers to “physicians who have staff privileges with one or more of the organization’s hospitals.” The second paragraph refers to “physicians who are employees practicing as physicians or who have staff privileges with one or more of the organization’s hospitals.” It is conceivable that some physician-employees of a hospital might not have hospital “staff privileges.” If it is intended that

⁴⁸ Rev. Rul. 1997-21, 1997-1 C.B. 121, 124.

such physicians be counted, we suggest that the Service modify the Instructions to use the same terminology in both paragraphs.

7. *Part V Facility Information*

Part V requires, for each facility included in Schedule H, a description of the nature of the facility. The first sentence of the Instructions for Part V (page 13) directs the use of a separate line on Part V for “[a]ny facility whose information is reported or included elsewhere in Schedule H.”

We suggest that the Service consider the following substitute for the referenced sentence to clarify its meaning: “If the results of the operations of a facility are reported or included in one of the Parts of Schedule H (other than Part V), then each such facility, and the appropriate description of its activities, must also be separately listed in Part V.”

8. *Worksheets*

The Instructions contain eight helpful worksheets to assist organizations in the completion of the chart found on Schedule H, Part I, line 7. In general, each of the worksheets relates to amounts which will appear on a separate line of the chart.

a. Worksheet 3

Worksheet 3 differs from the pattern of the other worksheets by combining the amounts which are to be reported on lines 7b and 7c of Part I. These lines call for the reporting of unreimbursed Medicaid costs and unreimbursed costs for other means-tested government programs, respectively.

Although Worksheet 3 contains separate columns for lines 7b and 7c, some users of Worksheet 3 might find it helpful if it were divided into separate worksheets for each line, consistent with the pattern of the other worksheets. We suggest that the Service consider so modifying Worksheet 3.

b. Grants to other tax-exempt entities included as part of costs

Worksheet 5 is used to calculate the cost of health professions education included as an “other community benefit” on line 7f of Part I. The Instructions for Worksheet 5 (at page 21) direct organizations to include as part of such cost “[g]rants made by the hospital to support health professions education programs run by other tax-exempt entities.”

Worksheet 4 is used to calculate the cost of community health improvement services reported on line 7e of Part I, and Worksheet 7 is used to calculate the cost of research reported on Part I, line 7h. The Instructions for these two worksheets do not contain a similar directive to include grants to organizations carrying out community health improvement programs or research. Instead, it appears that such grants instead would drop to the generalized category of cash contributions to community groups calculated on Worksheet 8 and reported on line 7i of Part I.

We suggest that the Service consider modifying the Instructions for Worksheet 4 and Worksheet 7 to include grants to other tax-exempt entities in the respective other community benefit costs calculated by these worksheets. Community health clinics and research programs are often carried out in collaboration with other tax-exempt organizations. A hospital's participation in these programs will often consist of the provision of in-kind contributions of the efforts of health professionals to provide free care, screenings, or research, and cash contributions to the sponsoring organization. In these circumstances, reporting the related grants on the same line as the in-kind costs would enhance transparency by segregating the various types of "other community benefits" based on their specific purpose, rather than reporting them in the less specific community group contributions category.

I. Schedule I

Our only suggestions with respect to Schedule I relate to the coordination of the reporting of grants to related organizations on Schedule I with the duplicative reporting of such grants on Schedule R. As detailed in these Comments in the discussion of Schedule R, we suggest that the Service require the reporting of grants to related organizations only once, on Schedule I.

J. Schedule J

We have no comments on Schedule J, other than those set forth herein in these Comments with respect to the related provisions of the Core Form.

K. Schedule K

1. General Instructions

Part IV of the Core Form, line 24a asks "[d]id the organization have a tax-exempt bond issue outstanding." The Instructions to Part IV of the Core Form direct an organization to respond "yes" if the organization "had any tax-exempt bond liabilities outstanding at any time during the tax year."

We recommend that the Service consider clarifying the Instructions to Part IV of the Core Form and Schedule K with respect to reporting of tax-exempt financings for "obligated groups" and "composite bond issues."

Systems of section 501(c)(3) organizations commonly use obligated group or similar financing structures in connection with tax-exempt financing. Under these structures, all of the members of the obligated group may have an obligation to provide for payment of debt service, even though only some of the members may benefit from a particular bond issue. In other financing structures, the "system parent" may be the only entity that is directly obligated to pay debt service.

In addition, systems of section 501(c)(3) organizations commonly cause to be issued tax-exempt bonds that are treated as a single "issue" for federal income tax purposes, but which benefit more than one of the members of the system. Such "composite issues" may commonly benefit a large number of section 501(c)(3) organizations within the system in many states. The

obligation to pay debt service on such obligations often may not directly mirror the actual benefits of a tax-exempt bond issue that are received by individual members of the system.

We suggest that the Service consider modifying the Instructions for the Core Form and Schedule K to permit the “system parent” to provide the required tax-exempt bond information in composite bond issues and obligated group tax-exempt financings. In most cases, the “parent” is the most likely entity to possess the necessary information. Since the liability relates primarily to the system as a whole, and will presumably be shown on the system parent balance sheet, as opposed to the balance sheets of individual members of the group, reporting at the “parent” level is most likely to enhance transparency by providing information that may be more readily understandable by users of Form 990. If desired, the Service could also require reporting of the secondary liability by the individual members of the group, but they should be permitted to report by cross-reference to the reporting by the system parent.

The Service might also consider modifying the Instructions to line 24a of the Core Form to indicate that a “yes” response is appropriate only if the organization is the “primary obligor” of tax-exempt bonds. If so modified, organizations that merely have secondary liability with respect to obligated group financings or composite bond issues could respond “no” and would therefore not be directed to complete Schedule K.

2. *Definitions*

a. Qualified 501(c)(3) bond

The Instructions define a “qualified 501(c)(3) bond” as a tax-exempt bond with proceeds used for the furtherance of the charitable purposes of a section 501(c)(3) organization. The Instructions go on to enumerate the section 145 provisions applicable to such bonds as including the requirement that “at least 95% of the net proceeds of the bond issue are used by either a governmental unit or a 501(c)(3) organization in activities which do not constitute unrelated trade or businesses (determined by applying section 513).”

Although the Instructions generally attempt with some success to simplify the description of technical provisions of the Code, the description of the requirements of section 145 is not technically correct. There is no affirmative requirement to so use 95% of the bond proceeds of an issue. Instead, a bond issue fails to qualify only if the private business use (including unrelated trade or business use) exceeds five percent *and* more than five percent of the debt service of the bond issue is secured by privately-used property or directly or indirectly derived from private payments.⁴⁹ In other words, a bond issue could fail to meet the stated 95% requirement, but still comply with the requirements of section 145.

We suggest that the Service consider modifying the Instructions to further elaborate upon the requirements of section 145 in the definition of “qualified 501(c)(3) bond.”

⁴⁹ Section 145(a)(2).

b. Defeasance escrow

The Instructions define “defeasance escrow” as “an irrevocable escrow established to redeem the bonds on their earliest call date in an amount that, together with investment earnings, is sufficient to pay all the principal of, and interest and call premiums on, bonds from the date the escrow is established to the earliest call date.” The definition also includes a reference to a provision of the Regulations⁵⁰ relating to a “remedial action” taken to cure private use noncompliance.

Part II, line 3, of Schedule K requires the reporting of “Proceeds in Refunding or Defeasance Escrows.” The Instructions to Part I, column (g), of Schedule K also indicate that defeasance or refunding escrows are to be reported if they have been established.

As a general matter, a remedial action defeasance escrow may not be funded with proceeds of tax-exempt bonds. In that light, the reference to the Regulations in the definition of “defeasance escrow” may be confusing to organizations preparing Schedule K. The portions of Schedule K calling for the reporting of “defeasance escrows” appear to call for the reporting of the existence of all defeasance escrows, but the Regulations reference may lead organizations to conclude that only remedial defeasance escrows are to be reported.

We suggest that the Service consider modifying the definition of “defeasance escrow” to remove the reference to the Regulations.

3. *Part I Bond Issues*

Part I, which is the only part of Schedule K required for 2008, requires organizations to list their outstanding bond issues. Column (e) requires the entry of the “issue price” of an obligation.

The Instructions summarize the rules for determining the “issue price” of the bonds under the Regulations⁵¹ and indicate that the issue price is determined under such Regulations. However, the Instructions state that if bonds are “issued for cash, the issue price is the price at which a substantial amount of the obligations are sold to the public.”

Under the Regulations, the issue price of bonds for which a bona fide public offering is made is determined on the sale date based on reasonable expectations regarding the initial public offering price, and may be different than the actual price at which obligations are sold.⁵² In addition, issue price is generally determined on a maturity-by-maturity basis.

We suggest that the Service consider modifying the Instructions to eliminate the above-quoted language. Alternatively, the Service may wish to add a more detailed explanation that includes more of the special rules set forth in the Regulations.

⁵⁰ Reg. § 1.141-12(d)(5).

⁵¹ Reg. § 1.148-1(b).

⁵² *Id.*

4. *Part II Proceeds*

a. Line 2

Part II of Schedule K requires organizations to provide information as to the use of proceeds of bond issues. Line 2 requests information regarding “Gross Proceeds in Reserve Funds.” The Instructions provide that the amounts reported on line 2 include “the amount of gross proceeds of the bond issue deposited into a reasonably required reserve or replacement fund, sinking fund, or pledged fund.”

We suggest that the Service consider adding “except for any bona fide debt service funds” to the Instructions for line 2. As a technical matter, bona fide debt service funds are “sinking funds” under the applicable Regulations,⁵³ but there would appear to be no compelling reason to report the amounts held in such funds.

b. Line 6

Line 6 calls for the reporting of “Capital Expenditures from Proceeds.” The Instructions state that a “working capital expenditure is any cost that is not a capital expenditure (e.g. current operating expenses).”

The Regulations provide that a number of different types of expenditures that may be working capital expenditures may be financed.⁵⁴ As a simplification measure, we suggest that the Service consider revising the Instructions to state that “interest on the issue for a period commencing on the issue date and ending on the date that is the later of three years from the issue date or one year after the date on which the financed project is placed in service” does not need to be included as a working capital expenditure. In addition, we suggest that the Service consider modifying the Instructions to clarify that costs of issuance should not be reported as working capital expenditures.

5. *Part III Private Business Use*

a. Line 3a

Line 3a of Part III requires organizations to report whether there are any management or service contracts concerning the financed property which could give rise to private business use. The Instructions refer organizations to Rev. Proc. 1997-13⁵⁵ for safe harbors with respect to management or service contracts.

⁵³ Reg. § 1.148-1(c)(2).

⁵⁴ Reg. § 1.148-6(d)(ii).

⁵⁵ 1997-1 C.B. 632.

Rev. Proc. 1997-13 was modified by Rev. Proc. 2001-39.⁵⁶ The Service may wish to consider changing the Instructions to include the reference to the modification.

b. Lines 4 and 5

Lines 4 and 5 of Part III ask for the percentage of financed property used in a private business use. The Instructions for both lines direct organizations to report “the highest percentage during the year.”

We suggest that the Service consider revising the Instructions for lines 4 and 5 to refer to the percentage of private business use, not the “highest percentage.” The Regulations refer to the “average of the percentages of private business use during the 1-year periods within the measurement period.”⁵⁷ The Regulations thus treat as the private business use percentage the highest percentage of use for 1-year periods, not the highest percentage of use within 1-year periods.

L. Schedule L

Schedule L, “Transactions with Interested Persons” and the corresponding Instructions, require section 501(c)(3) and section 501(c)(4) organizations to report additional details of any excess benefit transactions with “disqualified persons” that occurred in the reporting year, or in any previous year if the transaction was discovered in the reporting year. In addition, *all* exempt organizations filing Form 990 or Form 990EZ which had loans, grants or “business transactions” with a certain “interested persons” during the reporting year will need to report details of that transaction on Schedule L, Parts II through IV. Some of this information was previously required on the Form 990 for prior years, but Schedule L adds substantial detail and complexity to the reporting requirement.

1. *Part III Grants or Assistance Benefiting Interested Persons*

Part IV, line 26 of the Core Form directs organizations to complete Part III of Schedule L if they provided “a grant or other assistance to an officer, director, trustee, key employee, or substantial contributor, or to a person related to such individual.” On Schedule L, these persons are defined as “interested persons,” although the persons who are “interested persons” for Part III are not necessarily the same as those who are “interested persons” for purposes of Part II (requiring the reporting of loans) and Part IV (requiring the reporting of certain transactions).

“Grants or assistance” provided by the organization benefiting interested persons, defined in the Instructions as including the provision of goods, services, or use of facilities, must be reported. For purposes of Part III, “interested persons” include officers, directors, key employees, substantial contributors, or a “related person.” A “related person” is a member of the selection committee for the particular grant; a family member of officers, directors, trustees, key employees, substantial contributors, or selection committee members of the organization; a 35%

⁵⁶ 2001-2 C.B. 38.

⁵⁷ Reg. § 1.141-3(g)(3).

controlled entity of the foregoing; or an employee (and the employee's child) of a substantial contributor or 35% controlled entity.

This is a new reporting requirement, and will require additional tracking systems to ensure that all scholarships, fellowships, internships, prizes and awards that are granted to interested persons, as broadly defined, are included on Schedule L, Part III. The name of the interested person, the relationship between the person and the organization, and the amount of the grant must be provided. The Instructions specify that only grants to "interested persons" for which the recipient is not expected to provide "services, property, or other consideration except in furtherance of the purposes of the grant" are to be reported.

The administrative burden on the organization to verify that each and every grant of assistance is to an individual who is not within the very broad definition of "interested person" is substantial. This disclosure will require organizations to develop procedures for identifying scholarship recipients and other beneficiaries of common organizational assistance programs who have some relationship to the broadly defined list of "interested persons," even when such relationships were deliberately not disclosed to those making the decision regarding awarding of the scholarship or other assistance. We question whether such information will be relevant to users of Form 990 or to the Service for purposes of enforcement of the internal revenue laws.

We recommend that the Service consider modifying the Instructions to provide that those individuals who receive the grants or assistance in an objective process in furtherance of the organization's exempt purpose be excepted from the reporting requirement. This will relieve organizations of the considerable administrative burden of verifying the relationships of all recipients of grants or assistance, and confine Schedule L reporting to those forms of assistance which have some connection to the position of the "interested person."

2. *Part IV Business Transactions Involving Interested Persons*

Part IV, line 28, of the Core Form directs organizations to complete Part IV of Schedule L if persons who are current or former officers, directors, trustees, or key employees (as listed in Part VII, Section A, of the Core Form), their families, and certain entities in which they have an interest, have various business relationships with the organization. Part IV of Schedule L in turn contains a table calling for the name of the interested person, a description of the relationship between the interested person and the organization, the amount and description of the transaction, and whether the transaction involved any sharing of the organization's revenues.

The definition in the Instructions for "interested persons" is quite broad, and includes current and certain former officers, directors, trustees and key employees, and any entities in which these same individuals have a direct or indirect 35% ownership interest. In addition, any unrelated entity (including a management company) in which one of these individuals is serving, at the time of the transaction, as an officer, director, trustee, key employee, partner, or shareholder⁵⁸ is also an "interested person" and a financial transaction between that entity and the exempt organization must be reported on Schedule L.

⁵⁸ Only shareholders of professional corporations are included in this definition.

The definition in the Instructions for “business transactions” is similarly broad, with separate definitions for “direct” and “indirect” transactions. The Instructions specify that direct business transactions include contracts of sale, lease, license, performance of services, and certain joint ventures entered into directly with an interested person.⁵⁹ Indirect business transactions are transactions between the organization and a person related to an “interested person” in a variety of relationships further defined in the Instructions, including transactions with management companies partially owned or controlled by present or former interested persons.

The Instructions provide a helpful exception that transactions which do not exceed \$10,000 are not required to be reported. Also, there is an exception for those organizations with large boards of directors, defined as 20 or more voting directors or trustees. If the board of directors also has an executive committee with delegated powers to act on behalf of the board of directors, only the members of the board’s executive committee plus the organization’s officers, key employees, and highly compensated employees are included as interested persons.

Organizations are going to need to put into place extensive accounting procedures to track the information that will allow them to ensure that all business transactions are thoroughly analyzed to identify those with “interested persons,” and then record the substantial information required on Part IV of Schedule L. This is potentially an enormous expense for the organization, and diminishes the funds available for charitable purposes.

As discussed in these Comments with respect to the disclosure of relationships between directors, officers, and others required by Part VI, Section A of the Core Form, we are concerned that the Instructions for Part IV of Schedule L will require substantial expenditures of time by exempt organizations without leading to the reporting of any potentially useful information. In particular, the required disclosure of transactions with entities in which a director or trustee, or one of their family members, is a director, officer, or key employee, is likely to require the identification and disclosure of many routine business transactions that do not present any significant possibilities for abuse.

With respect to indirect transactions, we recommend that, instead of a fixed dollar amount, the Service require reporting only of transactions which exceed a percentage of the entity’s gross revenues. Thus, for example, disclosure could be required of transactions which exceed five percent of the revenues of the entity with which either a director or other specified person is affiliated. This would eliminate unnecessary reporting burdens for exempt organizations while still requiring the disclosure of business relationships that are sufficiently significant that they could give rise to potential concern due to the importance of the transaction to the entity doing business with the exempt organization.

We suggest that the Service also consider narrowing the definition of “interested person” to include only those persons that are currently in a position of control within the organization.

⁵⁹ A joint venture in which the organization’s profits or capital interest is greater than ten percent and the interested person’s profits or capital interest is also greater than ten percent is included as a reportable business transaction.

In that way, only the financial transactions that are susceptible to manipulation by the individual receiving the financial benefit of the transaction will be reported, thus minimizing the reporting and accounting burdens of the organization but still providing the Service and the public with useful information. Other transactions with individuals who fall within these broad categories but are not in a position of control would presumably be at arm's length, fair market value, since the individual involved in the financial transaction would not be in a position to cause the transaction to be anything other than at arm's length.

M. Schedule M

1. General Instructions

Schedule M is used to report "non-cash contributions." The Instructions provide that donations of services are not to be reported. However, the Instructions are silent as to whether organizations are to include donations of the use of facilities or equipment, such as governmental facilities furnished to the organization without charge and reported in the public support calculations on Schedule A.

We suggest that the Service consider amplifying the Instructions to indicate that contributions of the use of facilities or equipment need not be reported on Schedule M. The principal purpose of Schedule M appears to be the identification of types of contributions which might lead to valuation issues for donors. Contributions of the use of facilities or equipment do not produce deductible charitable contributions, and additional detail regarding such contributions does not appear to be necessary.

2. Part I Types of Property

a. Column (b)

The Instructions to column (b) give organizations the option to report either the number of contributions or the number of items contributed, in accordance with the organization's recordkeeping practices. Organizations are directed to explain in Part II of Schedule M which method they have adopted.

We suggest that the Instructions be clarified to indicate whether an organization may use both the number of items method and the number of contributions method. Although organizations presumably will use whatever consistent method they use for financial statement purposes, situations could arise where some combination of methods may be appropriate. For example, an art museum might ordinarily record the number of paintings or sculptures contributed, but count a series of small art objects as one item or contribution. We suggest that the Service permit whatever method or combination of methods the organization uses for its financial statement reporting.

b. Column (d)

Column (d)'s Instructions call for the organization to list the method of financial statement revenue recognition the organization used for each type of property. The Instructions

note that cost or selling price, comparable sales, replacement cost, and appraisals are permissible alternatives.

For organizations receiving large numbers of contributions of various types of items, it is likely that donors or the organization will value such items using various methods. For example, if the organization generally accepts the donor's valuation for financial statement purposes in the absence of contrary information, it is quite likely that appraisals or comparable sales, and other methods, will be used for various properties of the same type.

We suggest that the Service amplify the Instructions to indicate that organizations may list in column (d) multiple valuation methods for articles of the same type.

c. Line 3

Line 3 calls for the reporting of gifts of fractional interests in art. However, line 3 also calls for the reporting of gifts of "works of art." The Instructions do not provide any specific guidance as to whether fractional interests in works of art should be reported on both lines 1 and 3, or only line 3.

We suggest that the Service consider including in the Instructions for line 3 a direction that amounts reported on line 3 should not also be reported on line 1 in order to avoid double-counting.

d. Line 5

Line 5 is used for the reporting of donated clothing or household items. The Instructions provide that such items are to be included on line 5 only if in "good used condition or better." Other items are to be reported on one of the lines for "other" contributions beginning on line 25.

The Instructions provide no guidance to organizations in determining whether items are in "good used condition or better." We suggest that the Service provide some guidance to organizations in making this determination. For example, the Service might indicate that donated items which can be sold for more than a nominal value by the organization without significant alteration of the items are presumptively in "good used condition or better."

e. Lines 9-12

Lines 9 through 12 provide for the reporting of various types of securities, including publicly traded securities; closely held stock; partnership, trust, and LLC interests that are not publicly traded; and other securities which are not publicly traded. The Instructions do not provide any guidance as to which line is to be used for the reporting of contributions of interests in publicly traded partnerships.

We suggest that the Service modify the Instructions to specify the appropriate line for recording contributions of interests in publicly traded partnerships.

f. Lines 13-14

Lines 13 and 14 are used for the reporting of contributions of various types of property for conservation purposes. The Instructions provide information regarding the proper reporting for each line.

Part II of Schedule D also calls for reporting with respect to conservation easements. We recommend that the Service consider adding a reference to the Schedule D Instructions as a reminder that organizations reporting non-cash contributions on lines 13 or 14 should also complete Part II of Schedule D.

g. Line 18

Line 18 calls for the reporting of contributions of collectibles. The Instructions indicate that “collectibles” includes “books.”

Although the Instructions for line 4 indicate that “books” reported as “collectibles” on line 18 are not also to be reported on line 4, the Instructions for line 18 do not contain a similar caution (although guidance is provided with respect to costume jewelry reported on line 5 and art reported on one of the other lines). We suggest that the Service consider adding a cautionary note to the Instructions for Line 18 advising organizations not to report contributions of books on line 18 if they have been reported on line 4.

h. Lines 25-28

The Instructions for lines 25 through 28 direct organizations not to report on Schedule M “donated services which are reportable in Schedule D, Part XI, Line 5.” Schedule D, Part XI, line 5, however, calls for the reporting of “[d]onated services and use of facilities.”

As noted above in these Comments with respect to the general directions for Schedule M, the Instructions for Schedule M are not clear as to the reporting of the donated use of facilities. We suggest that the Service consider clarifying whether the reporting of donations of the use of facilities is intended on Schedule M.

i. Line 29

Line 29 requires the reporting of the number of Forms 8283 that the organization received and completed during the year. The Instructions for line 29 indicate that organizations which failed to keep record of the number of forms received should leave the line blank.

We suggest that the Instructions for line 29 remind organizations of the requirements for filing a Form 8282 upon the sale of the donated property. Organizations that do not keep records of the Forms 8283 they receive will be unable to comply with this requirement.

N. Schedule N

Schedule N calls for the reporting of transactions involving a liquidation, termination, or dissolution of the organization, or a significant disposition of the organization’s assets. Part I of

Schedule N relates to liquidations, terminations, or dissolutions. Our Comments relate to Part II, which calls for the reporting of the “Sale, Exchange, Disposition or Other Transfer of more than 25% of the Organization’s Assets.”

Part II must be completed if an organization answers "yes" to the question on line 32 of Part IV of the Core Form, which asks: “Did the organization sell, exchange, dispose of, or transfer more than 25% of its net assets or undergo a substantial contraction?” This question, and the related question on line 31,⁶⁰ implement the requirement of the Code that an exempt organization "file such return and other information with respect to [its] liquidation, dissolution, termination, or substantial contraction as the Secretary shall by forms or regulations prescribe.”⁶¹

In addition, as noted in the Highlights to the Schedule N Instructions, Part II of the new Schedule N calls for the reporting of information that is not in the Form 990 for 2007 and prior years (and is not currently required under the Regulations).⁶² The new Schedule N requires reporting of significant asset dispositions even if full consideration is received for the sale of such assets.

1. *“Significant Disposition of Net Assets” or “Substantial Contraction”*

The term "substantial contraction" is defined in the Regulations under section 6043. Under the Regulations, a “substantial contraction” includes "any partial liquidation or any other significant disposition of assets, other than transfers for full and adequate consideration or distributions out of current income.”⁶³ A “significant disposition of assets” requires a transfer of more than 25% of the net assets of the organization during the taxable year, or as part of a series of transactions over two or more taxable years.⁶⁴ Thus, under the Regulations, a “substantial contraction” includes a “significant disposition of assets,” but also a partial liquidation.

The Instructions do not define "substantial contraction," although the term is nonetheless used in Part IV, line 32, of the Core Form to trigger the filing of Part II of Schedule N. Instead, the Glossary directs organizations to the term “significant disposition of net assets," suggesting that the two phrases are intended to be synonymous. Schedule N itself does not use the term “substantial contraction.

We suggest that the Service consider simplifying the Instructions by stating that a “substantial contraction” has the same meaning as a “significant disposition of net assets.” Ideally, the Core Form could be amended to eliminate the use of the term “substantial contraction,” since it does not appear to have any independent significance in Schedule N or the

⁶⁰ "Did the organization liquidate, terminate, or dissolve and cease operations?"

⁶¹ Section 6043(b).

⁶² See Reg. § 1.6043-3(a), (d)(1)(i).

⁶³ Reg. § 1.6043-3(d)(1)(i).

⁶⁴ *Id.*

Instructions. However, if that is not possible, we recommend that the Instructions at least inform readers as to the intended meaning of the term.

2. “Significant disposition”

The Instructions and the Glossary indicate that “[a] significant disposition of the organization's net assets includes a sale, exchange, disposition, or other transfer of more than 25 percent of its net assets to another organization during the taxable year, regardless of whether the organization received full and adequate consideration.” The Instructions and the Glossary further provide that “[a] significant disposition of net assets involves” (1) the disposition in a single year, in one or more dispositions, of 25% or more “of the fair market value of the organization’s net assets as of the beginning of its tax year,” or (2) a multi-year series of related dispositions exceeding 25% of the organization’s net assets in the year in which the series of dispositions began.

The Instructions and the Glossary further provide, however, that the “types of sales or exchanges required to be reported” include the following:

- taxable or tax-free sales or exchanges of exempt assets for cash or other consideration (such as a social club described in section 501 (c)(7) selling land or other exempt organization selling assets used to further its exempt purposes);
- sales, contributions or other transfers of assets to establish or maintain a partnership, joint venture or a corporation (for-profit or nonprofit) regardless of whether such sales or transfers are governed by section 721 or 351, and whether or not the transferor receives an ownership interest in exchange for the transfer;
- sales of assets by a partnership or joint venture in which the organization has an ownership interest[; and]
- transfers of assets pursuant to a reorganization in which the organization is a surviving entity."

These provisions of the Instructions raise a number of questions.

a. Are there alternatives to the 25% requirement?

The first sentence of the definition of “significant disposition of the organization’s net assets” provides that such disposition “includes” a transfer of more than 25% of the organization’s assets in a single year. The next provision of the definition repeats the 25% requirement as applied to transfers during a single year, or as applied to a series of related transfers over multiple years.

Does the “includes” language suggest that there are other circumstances which could qualify as a “significant disposition” even if the 25% requirement is not met? If no other circumstances are contemplated, then the Instructions would be easier to understand if they simply stated that “[a] significant disposition of the organization's net assets *is* a sale, exchange, disposition, or other transfer of more than 25 percent of its net assets to another organization, regardless of whether the organization received full and adequate consideration.” We

recommend that the Service consider making this modification to eliminate a potential point of confusion for readers.

b. Are major dispositions required, or are routine grants and inventory sales covered?

The Regulations under section 6043 expressly exclude from the events triggering reporting requirements "transfers for full and adequate consideration or distributions out of current income."⁶⁵ The Highlights to the Schedule N Instructions indicate that transfers for full and adequate consideration are now to be reported. The Instructions further provide that "net assets" for purposes of the 25% test will be total assets less total liabilities.

Although the examples in the Instructions of "significant" dispositions seem to generally involve "major" transactions, such as land sales, formation of a new entity, or a reorganization, the reporting required by the Schedule N Instructions is likely to sweep in a very broad range of transactions, including routine grants and inventory sales. As a result, the vast number of organizations relying on current revenues to finance their operations will be subject to the Schedule N, Part II reporting requirements.

Consider the following examples:

Example 1. Organization P, a religious publisher, has net assets of \$35 million and annual gross sales of publications of \$50 million. Its balance sheet assets consist primarily of its inventory of publications, its publishing facilities and equipment, cash for working capital, and accounts receivable from publication sales.

Example 2. Organization U, a federated fundraising organization, has net assets of \$40 million, annual gross contribution income of \$65 million, and makes annual grants to the social service agencies in the community supported by the organization in the amount of \$60 million.

In each of the above examples, sales or other dispositions during the year would exceed 25% of the organization's net assets. Thus, Organization P and Organization U would have to complete Schedule N.

We recommend that the Service modify the Instructions to provide that routine asset sales for full consideration, and routine grants funded by current contributions, are not "significant dispositions of net assets." If the current definitions in the Instructions are not modified, every United Way and all similar fundraising organizations will have to complete Schedule N, duplicating information that is reported on Schedule I. Similarly, organizations which make substantial sales of goods in furtherance of their exempt purposes are likely to be required to complete Schedule N. We do not believe such routine transactions should require the detailed reporting appropriate for a transaction which actually results in a substantial permanent diminution or change in the assets of an organization.

⁶⁵ Reg. § 1.6043-3(d)(1)(i).

3. *Listing of transferees*

The Instructions for Part II, line 1 require the same information as is required in Part I, line 1 for a liquidation, termination, dissolution or merger. A liquidation or merger is a single event, normally involving a limited number of distributees.

A significant disposition of assets may be produced by the accumulation of multiple events, not necessarily related, occurring throughout a year. These events, including sales and other dispositions to multiple unrelated transferees, individually may not involve significant dollar amounts.

We recommend that the Service modify the Instructions to establish some threshold below which transactions need not be reported in Part II, even if together with other transactions they cause a significant disposition of assets to occur. Consider for example, a library which both disposes of a branch or other facility, and sells to members of the public the used books culled from its collection at the facility. It is impractical to require the collection and reporting of each book purchaser's name, address, and EIN, even though such purchases may have been part of the significant disposition of the library facility. We suggest that the Service consider adopting a \$10,000 per purchaser or distributee minimum reporting threshold similar to the transaction expense reporting threshold adopted for Part I, line 1, column (a).

4. *Defining "successor or transferee"*

Schedule N, Part II, lines 2a, 2b, and 2c, require the reporting of relationships of the organization's current officers, directors, trustees, or key employees with "a successor or transferee organization." Such terms are not defined in the Instructions or Glossary.

We suggest that the Service consider modifying the Instructions to define such terms, either in the Instructions or the Glossary. For example, a "transferee" might be defined as an organization listed on line 1 of Part II.

O. Schedule O

We have no suggestions with respect to Schedule O.

P. Schedule R

Schedule R requires that organizations report their interest in "related organizations."

A "related organization" is defined in the Glossary and the Instructions as an organization that is a parent, subsidiary, or sibling organization of the filing organization. Related organizations also include a supporting or supported organization with respect to the filing organization.

The first three relationships are defined by "control." "Control" for the purpose of the related organization test is also defined in the Glossary and the Instructions.

For nonprofit organizations, control means the power to remove and replace a majority of directors or trustees, or management overlap, where a majority of the controlled entity's directors or trustees are directors, trustees, officers, employees, or agents of the controlling organizations.

For other entities, including partnerships or corporations, control is defined in the Instructions as follows:

- ownership of more than 50% of the stock (by voting power or value) of a corporation,
- ownership of more than 50% of the profits or capital interest of a partnership, . . . [or LLC],
- being a managing partner or managing member in a partnership or LLC which has three or fewer managing partners or managing members (regardless of which partner or member has the most actual control),
- being a general partner in a limited partnership which has three or fewer general partners (regardless of which partner has the most actual control),
- being the sole member of a disregarded entity, or
- ownership of more than 50% of the beneficial interests in a trust.

Schedule R asks that an organization identify in Part III its related organizations taxed as partnerships. Unrelated organizations taxed as partnerships are to be identified in Part VI if the organization conducted more than five percent of its total activities through the partnership, measured either by total assets or gross revenue.

1. *Definition of "control"*

a. Partnerships with differing management control and profits or capital interests

The definition of "control" in the Glossary and the Instructions does not always equate with management control. The definition of control with respect to partnerships and limited liability companies is defined by reference to profits or capital interests.

In some cases, an exempt organization may own 50% or less of the profits or capital interests in a partnership, yet control the joint venture by virtue of being able to appoint or remove a majority of the management board.

We recommend that the Service modify the control definition to include situations where the organization controls a body responsible for the operational management of the partnership or LLC, even if the organization does not own a greater than 50% profits or capital interest in the partnership or LLC. Where the organization has the power to control the operations of the partnership or LLC, the most appropriate reporting for the entity would be in Part III of Schedule R. Otherwise, the organization would report the joint venture in Part VI, which applies to

unrelated organizations taxable as partnerships, which would result in an inaccurate reflection of the organization's actual control over the joint venture.

b. Appointment powers

The "control" definition in the Instructions with respect to not for profit corporations includes the power to remove or replace a majority of the directors or trustees of the corporation. No mention is made of the ability to appoint directors or trustees.

We suggest that the Service consider including as an additional factor demonstrating control of nonstock corporate entities the ability to appoint a majority of the directors or trustees of the corporation. Removal powers are sometimes limited or not specified in the corporation's governing documents; however, if the organization controls the appointment of directors or trustees, including those appointed to fill vacancies, it nonetheless has effective control of the corporation. Such control should be reported in Schedule R.

c. "Management" overlap

The Instructions also provide that "control" exists in the case of "management overlap." "Management overlap" is defined, however, not by reference to overlapping officers or key employees, but rather to majority control of the board of directors (or trustees) of the organization by directors, officers, employees, or agents of the controlling organization.

We recommend that the Service consider defining this form of "control" as "management or board overlap," since "management" may connote to some readers of the Instructions control exercised only by officers, employees, or agents of the controlling organization.

2. *Part II Identification of Related Tax-Exempt Organizations*

a. Functionally integrated supporting organizations

The Schedule R Instructions for column E of Part II ask for a brief description of the public charity status of an identified, related tax-exempt organization. It further asks, if the related organization is a Type III "supporting organization," whether or not it is "functionally integrated."

As we noted in our Comments to Form 990, the Service has not yet provided any formal guidance concerning qualification as a "functionally integrated" Type III "supporting organization." It will be difficult for some organizations to complete this question for the 2008 tax year if guidance has not yet been provided. We suggest that the Service eliminate this requirement if guidance is not anticipated before the return due date for calendar year Form 990 filers.

b. Related organization control

The Schedule R Instructions for column F of Part II state that if the organization controls the related organization "through one or more other organizations," the organization should state the name of the entity that directly controls the related organization. We recommend that the

Service consider changing the language to read “through one or more related organizations.” Use of this terminology will reinforce that the other organization should also be reported on Schedule R.

We also recommend that the Service consider making the same type of change to the Schedule R Instructions for column D of Part III and column D of Part IV.

3. *Identification of Related Organizations Taxable as a Corporation or Trust*

The Schedule R Instructions for column F of Part IV ask the organization to state the “dollar amount of the organization’s hypothetical share of the C corporation’s total income.” The Instructions provide the method for computing such “hypothetical share” for a C corporation which involves the calculation of the organization’s percentage ownership of the corporation and multiplying such percentage by the corporation’s income.

Rather than using the phrase “hypothetical share,” we suggest that the Service consider utilizing the same percentage required to be stated on column H. Column H already calls for, and the Instructions explain, the method of calculating percentage ownership. The Instructions for column F could then be simplified by replacing the two sentences relating to C corporations with the following: “For a related organization that is a C corporation, state the dollar amount of the organization’s share of the C corporation’s total income, based on the percentage ownership set forth in column H.”

4. *Transactions with Related Organizations*

a. Reporting threshold

The Schedule R Instructions for line 2 of Part V indicate that transactions of a particular type (loan, grant, sale of assets, lease, performance of services, or other transaction) between two organizations do not have to be reported if the aggregate amount involved for the year does not exceed \$50,000. This is a welcome change from the originally proposed Form 990.

While the increased threshold is beneficial, the volume of transactions reported is likely to still create challenges to large organizations in compiling the relevant data and also may make Schedule R difficult to interpret by readers of Form 990. As noted in our prior Comments to the Form 990, we suggest that the Service consider incorporating a percentage threshold for determining the transactions to be reported on Schedule R based on the size of the organization and the aggregate volume of similar transactions involved. For example, a threshold of the greater of \$50,000 or two percent of gross revenue of the organization might be applied.

b. Coordination with Form 990-T

The \$50,000 threshold does not apply to the “receipt of interest, annuities, royalties, or rent from a controlled entity, which are to be reported regardless of amount.” These amounts are also required to be reported on Schedule F of Form 990-T.

We suggest that the Service consider including in the Instructions a note or tip that the amount reported on column C of line 2 for interest, annuities, royalties or rent from a controlled entity should be based on those amounts reported on Schedule F of Form 990-T.

c. Reporting of shared facilities or assets

Line 1m of Part V asks if there has been a sharing of facilities, equipment, mailing lists, or other assets with one or more related organizations. Line 1n of Part V asks if there has been a sharing of paid employees with one or more related organizations. Column C of line 2 of Part V asks the organization to state the amount involved for these transactions.

It is common for related tax-exempt organizations to provide assets and employees without charge to each other. In the context of related section 501(c)(3) organizations which prepare financial statements on a consolidated basis, the determination of a precise value for the sharing arrangements may require considerable resources. We suggest that the Service provide examples in the Instructions of appropriate methods for determining the amount involved for these types of transactions, and indicate that any reasonable method of determining such amounts is acceptable.

d. Coordination with Schedule I

Part II of Schedule I requires the reporting of “Grants and Other Assistance to Governments and Organizations in the United States.” Schedule I contains a table calling for the reporting of the name and address of the recipient organization, its EIN, the source of its tax-exempt status, and the amount (cash or non-cash) and purpose of the grant.

Line 1b of Part V of Schedule R requires organizations to disclose whether they made any “gift, grant, or capital contribution” to a related tax-exempt organization, a related organization taxable as a partnership, or a related organization taxable as a corporation or trust. If the organization indicates that it made such a gift, grant, or capital contribution, the details must be provided in the table on line 2 of Part V of Schedule R. Information required includes the name of the organization, the type of the transaction, and the amount involved.

We recommend that the Service consider modifying the Instructions to provide that organizations which have already listed all of their grants to related organizations on Schedule I need not repeat that information on Schedule R. The Service might include in the Instructions a direction to organizations to insert the following cross-reference to Schedule I on line 2 for a complete description of such grants: “See Schedule I for grants to related exempt organizations.” No further details should be required regarding such grants on Schedule R, since Schedule I already calls for more detail than Schedule R requires.

5. *Part VI Unrelated Organizations Taxable as a Partnership*

Question 37 of Part IV of the Core Form asks whether the organization conducted more than 5% of its “*exempt activities*” through an entity that was not a related organization and that was taxed as a partnership. If the organization answers “yes,” then the organization is directed to complete Schedule R, Part VI.

The Instructions to Part VI of Schedule R gives as an example an organization that conducts unrelated activities through a joint venture. If the Service intends that nonexempt activities that are not excluded from reporting by the passive investment income exception be reported on Part VI of Schedule R, we suggest that Service consider modifying the Instructions to include an express statement so indicating. A similar statement should be included in the Instructions to Part IV, line 37, of the Core Form.