

2011 Form 990 – Issues for Public Comment

Announcement 2011-36

PURPOSE

This Announcement invites public comments on transitional issues and frequently asked questions involving the redesigned Form 990.

BACKGROUND

The IRS extensively redesigned Form 990, *Return of Organization Exempt from Income Tax*, for tax year 2008 to promote tax compliance and increase transparency.

The redesign was a collaborative process based on the over 800 formal public comments on drafts of the 2008 Form 990, schedules, and instructions.

The major reconstruction of the Form is complete, but the IRS continues to refine the Form in response to questions and comments from the public. We have made many revisions to the 2009 and 2010 Forms 990, schedules, and instructions, mostly corrections and clarifications to make the Form easier to understand and complete, and plan to make further revisions. As the second filing season for the redesigned Form nears completion, the IRS invites public input on the following issues.

ISSUES FOR PUBLIC COMMENT

1. Activity codes.

Part III of the Form 990 includes spaces for reporting activity codes to characterize certain program service activities. The instructions ask filers to leave these spaces blank for tax year 2010, because the IRS has not decided which, if any, coding system would best facilitate research on exempt organizations by the IRS and the public. All

such coding systems that the IRS is familiar with, including the National Taxonomy of Exempt Entity (NTEE) codes, the North American Industry Classification System (NAICS) Business Activity Codes and the IRS's internal activity codes, have significant limitations. In particular, these systems do not adequately reflect the wide range of program service activities provided by tax-exempt organizations. These systems also lack the consistency, flexibility, and real-time adaptability that would be needed to facilitate complete and accurate reporting.

In light of these limitations, the IRS is considering removing the spaces in Part III for reporting activity codes. We request comments on whether removal is preferable to the adoption of a coding system.

2. Reporting compensation to management companies and leasing companies owned or controlled by directors, officers, trustees, or key employees.

In 1999, the Service added the following instruction to the Form 990 to address the practice of officers, directors, trustees, and/or key employees (ODTKEs) organizing management companies and other separate legal entities to avoid reporting of their compensation on the Form 990:

If you pay any other person, such as a management services company, for the services provided by any of your officers, directors, trustees, or key employees, report the compensation and other items as if you had paid them directly.

The instruction generated controversy and much commentary. Some argued that these reporting requirements were burdensome, requiring the organization to obtain detailed information from third-party contractors; others argued that the requirements invaded the privacy of individuals who were not employees of the filing organization.

In Announcement 2001-33, the IRS said it would not penalize an organization if it

reported in the compensation section of its Form 990 the name of a management company it paid for services rather than the person who provided services to the organization on behalf of that management company.

The redesigned 2008 Form 990 expanded upon Ann. 2001-33 by stating in the Part VII instructions that the filing organization should not report a payment to a management company as a payment directly to an ODTKE, even if that ODTKE owned or controlled the management company. Rather, the compensation to the management company would only be reported in Part VII, if at all, as compensation to one of the organization's five most highly compensated independent contractors. The one exception to this rule is to report employees of a management company as the organization's own employees if they are common law employees of the organization under state law. (Also, if an ODTKE of the organization received compensation through a management company of which the ODTKE or a family member was a 35% owner, director, officer, or key employee, then the transaction may need to be listed and explained in Schedule L, Part IV, including the amount of the payment to the management company and the ODTKE's relationship with the management company.) The Form 990 instructions also state that payments to leasing companies should be treated in the same way as payments to management companies.

Some have expressed concern that this type of reporting allows organizations to shield compensation to highly-paid executives from disclosure by paying those executives indirectly through management companies. Others have explained the difficulty of determining whether a person is a common law employee under state law.

In light of these concerns, the IRS requests further comments on how a filing organization's payments to management companies and other third parties (e.g.,

leasing companies, affiliates of filing organization, professional employer organizations) for an ODTKE's services to the filing organization should be reported on the Form 990. For instance, should an organization's payments to another person or entity, such as a management company, for the services provided by any of the organization's ODTKEs be reported on the Form 990 as compensation by the filing organization to the ODTKEs? Should the IRS retain its current instructions for reporting compensation in this scenario? Should the IRS ask about such third party compensation arrangements in a separate section of Part VII, to increase transparency?

3. Thresholds for reporting compensation to key employees, highest compensated employees, independent contractors, and former officers, directors, trustees, and key employees.

Part VII of the Form 990 requires the organization to list:

- ▶ all persons who served as its officers, directors, and trustees during the tax year;
- ▶ its top 20 highest compensated "key employees" (not including officers and directors/trustees); that is, employees who had certain management responsibilities and received over \$150,000 of reportable compensation from the organization and related organizations, in the aggregate;
- ▶ its top 5 highest compensated employees (not including officers, directors/trustees, and key employees) who received over \$100,000 of reportable compensation from the organization and related organizations, in the aggregate;
- ▶ any of its former officers, key employees, or highest compensated employees (who had served in such capacities in the prior five years but not in the current tax year) who

received over \$100,000 of reportable compensation from the organization and related organizations, in the aggregate;

- ▶ any of its former directors or trustees (who had served in such capacities in the prior five years but not in the current tax year) who received over \$10,000 of reportable compensation from the organization and related organizations, in the aggregate, for services provided in the person's capacity as director or trustee; and
- ▶ its top 5 highest compensated independent contractors that the organization paid more than \$100,000.

These reporting thresholds became effective for tax year 2008. Prior to 2008, the Form 990 compensation reporting threshold for independent contractors and highest compensated employees was \$50,000, rather than \$100,000. Prior to 2008, the definition of key employee did not include any compensation threshold. Also prior to 2008, all former officers, directors, and trustees who received compensation during the tax year were reportable, regardless of their level of compensation.

Some have expressed concern that these increased thresholds decrease transparency, and prevent reporting of some persons who receive unreasonable compensation. Others have suggested that a single, uniform reporting threshold be adopted. The IRS requests comment on whether some or all of these Form 990 compensation reporting thresholds should be lowered, raised, or retained as is.

4. Reporting revenue from governmental units.

The instructions for Form 990, Part VIII distinguish between reporting of contributions and program service revenue from governmental units. A payment from a governmental unit should be reported as a contribution on Part VIII, line 1e (government

grants (contributions)) if its primary purpose is to enable the organization to provide a service to or maintain a facility for the direct benefit of the public, rather than to serve the direct and immediate needs of the governmental unit. A payment from a governmental unit should be reported as program service revenue on Part VIII, line 2 if it represents a payment for a service, facility, or product that primarily gives some economic or physical benefit to that governmental unit. The instructions provide various examples of how such payments should be characterized and reported.

Some have expressed concern that the Form 990 does not provide for sufficient transparency in reporting of revenue from governmental units because much of this revenue is included in program service revenue in line 2, rather than as “Government grants” in line 1e. Accordingly, the IRS requests further comments on whether and how it should change reporting requirements in this area. For instance, should Part VIII, line 2 be revised to itemize certain government payments, such as Medicaid and Medicare payments? Should Part VIII, line 1e and/or the instructions for that line be revised to clarify that government contributions may include grants made pursuant to government contracts?

5. Net asset reconciliation.

The 2007 Form 990 included a “Net Assets” section that required filers to reconcile discrepancies between net assets or fund balances from the prior to current tax year. This section was removed from the redesigned 2008 Form 990, but an expanded section for net asset reconciliation was included in the new Schedule D, *Supplemental Financial Statements*, which most but not all Form 990 filers are required to complete.

In response to many requests to include a net asset reconciliation section in the Core Form, the IRS has added a new Part XI, Net Asset Reconciliation, to the 2010 Form 990. Subsequently, some have commented that Schedule D, Part XI is now redundant.

The IRS requests comments on whether the Net Asset Reconciliation section in Schedule D, Part XI is still needed and, if so, how it should be revised to avoid or minimize redundancy.

6. Reporting on audited financial statements.

Form 990, Part XII, line 2 requires organizations to report whether their financial statements were compiled, reviewed, or audited by an independent accountant, and whether those financial statements were *issued* on a separate or consolidated basis.

Suggestions have been made that Part XII should require additional reporting on audited financial statements. For instance, some have suggested that Form 990 filers should report whether their financial statements were *audited* on a separate basis by an independent accountant. Others have suggested that a Form 990 filer should report whether its auditor issued a qualified opinion, an unqualified opinion, an adverse opinion, or a disclaimer of opinion regarding the organization's financial statements, and to explain in Schedule O if such opinion was qualified, adverse, or a disclaimer. The IRS requests comment on whether this additional reporting should be required.

7. Names and EINs of foreign grantees.

The redesigned Form 990 includes a Schedule F, *Statement of Activities Outside the United States*. Part II of this Schedule, *Grants and Other Assistance to Organizations*

or *Entities Outside the United States*, includes a column (a) for reporting the name of each grantee organization and a column (b) for reporting of the employer identification number (EIN) and IRS code section (if applicable) of each grantee. In response to public comment that disclosure of such information could jeopardize the confidentiality of sensitive foreign operations and the safety of such grantees, the IRS retained but shaded out these two columns so they could not be completed for tax years 2008-2010.

The IRS invites comment on whether these two columns should be unshaded or, alternatively, deleted entirely from Part II, and the rationale for taking such action.

8. Indirect foreign expenditures.

When the IRS released the instructions for Schedule F, some commented that it would not be possible for their organizations to report certain foreign expenditures on Schedule F, because they lacked accounting systems that tracked *indirect* foreign expenditures (e.g., the expenses of listing a “study abroad” program in a school’s website or paper catalog). For tax years 2008-2010, the IRS has allowed organizations not to report such indirect expenditures on Schedule F if the organizations do not separately track them.

The IRS requests comment on whether this instruction should be revised now that Form 990 filers have had several years to develop procedures and adopt systems to separately track indirect foreign expenditures. Particularly, should the IRS require that all Schedule F filers account for and report indirect foreign expenditures in Part I, line 3, column (f)?

9. Reporting bank deposits as loans or business transactions on Schedule L.

In its list of Frequently Asked Questions on Form 990, Schedule L, *Transactions with Interested Persons*, the IRS states that, for tax years 2008-2010, deposits into and withdrawals from a bank account do not constitute “payments” or “business transactions” that need to be reported in Schedule L, Part IV, nor do such deposits constitute “loans” that need to be reported in Schedule L, Part II. See <http://www.irs.gov/charities/article/0,,id=215126,00.html>. The IRS requests comment on the pros and cons of requiring reporting of such deposits and withdrawals as business transactions in Schedule L, Part IV, or reporting deposits as loans in Schedule L, Part II.

10. Reporting of component parts of community trusts on Form 990-series returns.

Under Regulation §1.170A-9(T)(f)(11), any separately organized trust, not-for-profit corporation, or association that meets certain requirements may be treated as a component part of a community trust, and that trust may be treated as a single entity rather than as an aggregation of separate funds, for purposes of sections 170, 501, 507, 508, 509, and Chapter 42 of the Code. One benefit of an organization being treated as a component part of a community trust is that the organization is not required to independently meet the public support requirements for public charity status.

The IRS has not required separately organized component parts of community trusts to file separate Forms 990. Schedule A (*Public Charity Status*), Part I, line 8 asks a filing organization that is a “community trust described in section 170(b)(1)(A)(vi)” to check the box and complete Schedule A, Part II to establish its public support status.

Otherwise, Form 990 and Form 990-EZ do not ask any specific questions about community trusts or their component parts.

The IRS requests comments on whether separately organized component parts of community trusts should file separate Form 990-series returns or, if not, how to increase transparency in reporting by community trusts and their component parts. In particular, what, if any, types of information regarding component parts of community trusts should be reported on a component part-by-component part basis rather than on an aggregate basis on Form 990-series returns? For instance, should reporting be required for each component part's employer identification number (if any), trustees' names and relationships to the trust (e.g., donor, disqualified person, commercial trustee), compensation to trustees, annual income, annual expenses, total assets, closely held business interests, real estate holdings, and/or charitable distributions?

11. Scope of related organization reporting on Schedule R.

The Form 990 requires reporting of related organizations on Schedule R. This reporting provides the IRS and the public with a more complete picture of the organization's structure and controlling relationships. For purposes of Form 990, "related organization" means an organization that controls or is controlled by the filing organization, is controlled by the same person or persons who control the filing organization, is a 509(a)(3) supporting or supported organization of the filing organization, or is a sponsoring organization of or contributing employer to a filing organization that is exempt under section 501(c)(9) as a voluntary employees' beneficiary association (VEBA). Schedule R contains exceptions for reporting of certain

related organizations (e.g., certain bank trustees, subordinate organizations of a group exemption included in the central organization's group return).

Some have expressed concern that Schedule R requires reporting that, in some cases, is overly burdensome (e.g., reporting of religious organizations and churches in a religious denomination or association, affiliates in a hospital system, chapters of a national organization) and/or compromises the confidentiality of the related organizations and/or their employees (e.g., reporting of foreign affiliates, charitable remainder trusts, contributing employers of VEBAs), and have asked that such organizations be excepted from reporting in Schedule R. The IRS requests comment on the pros and cons of adopting these or similar Schedule R exceptions.

REQUEST FOR COMMENTS

The IRS requests comments on the issues described above. Comments should be submitted in writing on or before August 1, 2011. Please include "Announcement 2011-36" on the cover page. Comments should be sent to the following address:

Internal Revenue Service
Attn: Stephen Clarke (Announcement 2011-36)
SE:T:EO (3C1)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Internal Revenue Service
Courier's Desk
1111 Constitution Ave., N.W.
Washington, DC 20224
Attn: Stephen Clarke (Announcement 2011-36)
SE:T:EO (3C1)

Submissions may also be sent electronically to the following e-mail address:

Form990Revision@IRS.gov

Please include "Announcement 2011-36" in the subject line.

All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this announcement is Stephen Clarke of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this announcement, contact Mr. Clarke at (202) 283-9474 (not a toll-free call).