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June 2, 2008

Lois G. Lerner  
Director, Exempt Organizations Division of the IRS

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

Internal Revenue Service  
Draft 2008 Form 990 Instructions, SE:T:EO  
1111 Constitution Avenue, NW  
Washington, DC 20224

**RE: Comments on Draft 2008 Form 990 Instructions**

Dear Ms. Lerner and Mr. Schultz:

Thank you for the opportunity to review and comment on draft instructions for the redesigned Form 990 proposed by the IRS on April 7, 2008. We commend you and your staff for your exceptional effort to bring greater clarity to the revised Form 990 and address concerns expressed by the nonprofit community in response to the initial draft revised Form.

The draft instructions add a number of new tools that will facilitate more consistent, accurate reporting by nonprofit organizations. Nonetheless, we have several recommendations and suggestions which we encourage the Service to address in the final instructions.

**Highlights and General Instructions**

We found the highlights to be extremely helpful, and we recommend that they be retained as part of the final instructions. We also found the glossary to be a helpful addition, and we recommend that terms included in the glossary be printed in boldface type, or some other identifying typeface, throughout the instructions.

### **Program Service Accomplishments (Part III)**

The instructions of Part I, line 1, and Part III, line 1, correctly state that filing organizations should “describe the organization’s mission as articulated in its mission statement or as otherwise adopted by the organization’s governing body, if applicable.” While the governing body does bear primary responsibility for setting the vision and mission of the organization, it is not uncommon for organizations to have mission statements that have not been formally adopted by their governing bodies. The fact that the governing board has not formally approved or adopted the mission statement does not invalidate that statement.

***Therefore, we recommend that the final statement – “If the organization does not have a mission that has been adopted by its governing body, leave this blank” – be removed.***

As we noted in our comments on the draft Form 990, information about the filing organization’s program service accomplishments is essential for setting the context for governance, compensation, and financial information. An increasing number of charitable organizations are paying close attention to the best methods of describing the value of the services they provide to communities and the many different ways in which they improve lives. These methods can vary substantially, even with seemingly similar organizations, depending on the size and structure of the organization and the needs of the community it serves. ***Given the diversity of program services offered by organizations even within the same sub-sector (e.g., nursing homes, hospitals, etc.), we do not recommend at this time that the Service strive to impose uniformity through examples on how organizations should describe their program services.*** If the Service does choose to provide examples of how organizations might wish to describe their services, it should state explicitly that organizations are not proscribed from describing program accomplishments in a manner that most appropriately reflects their own mission and service objectives.

We remain concerned that the filing organizations can only report the direct program service revenues, not including charitable contributions and grants, that support their program activities. This results in a misleading picture of activities that contribute to – or subtract from – the organization’s bottom line. ***Since the instructions specifically indicate that organizations can report “the amount of any donated services, or use of materials, equipment, or facilities it received or used in connection with a specific program service, on the lines for the narrative description of the appropriate program service,” we recommend that the instructions also include a similar section regarding charitable contributions.***

### **Activity Codes (Part III and Part VII)**

The Service notes that organizations should leave blank the activity codes for Part III, line 4, while it solicits comments on whether to rely on existing codes or develop new codes. However, on Part VII, line 2, column (A), the instructions call on filing organizations to code both related and unrelated program activities using the corresponding business code from the *Codes of Unrelated Business Activity* from the 2008 Form 990-T. As we stated in our September 2007 comments on the draft Form 990, we do not believe that the business codes used to describe unrelated business activities are appropriate for coding revenues from

exempt services. We continue to believe that the National Taxonomy for Exempt Entities (NTEE) is the most appropriate system for classification of nonprofit organizations and their program activities, but we recognize that further adjustments in NTEE are necessary to accommodate the full range of exempt activities undertaken by filing organizations. ***We again recommend that the IRS convene organizations like The Foundation Center, the National Center on Charitable Statistics, and Independent Sector, as well as other organizations and research programs with an interest in and experience with NTEE and other coding systems, to make the appropriate adjustments to NTEE. We further recommend that the Service amend the instructions to require that organizations apply the unrelated business codes only to their non-exempt activities on Part VII, line 2, column (A).***

#### **Checklist of Required Schedules (Part IV)**

***Indirect Political Activities (Part IV, line 3):*** The Service has made a significant contribution in its descriptions of lobbying, advocacy, and political activities undertaken by exempt organizations in the instructions for Schedule C. Nonetheless, we are concerned that the draft instructions for Part IV, line 3, indicate that a filing organization must answer “yes” – and possibly jeopardize its exempt status – if political activities were undertaken by a partnership or other arrangement in which the organization is an owner, regardless of the extent of its ownership. This appears to be much more comprehensive than any previous guidance of which we are aware, and could raise significant confusion among 501(c)(3) organizations that are involved in, but are not a controlling or majority owner of, a joint venture or other partnership arrangement. While the concept behind this new reporting requirement appears to have value, many exempt organizations may need to reexamine and possibly withdraw from any such ventures which may have conducted or could conduct political activities without the exempt organization’s knowledge or approval. ***We therefore recommend that the IRS permit organizations a reasonable period in which to withdraw from or make any necessary adjustments to their existing joint venture or partnership agreements to be certain that the joint venture or partnership does not engage in political activities that could jeopardize the 501(c)(3) organization’s exempt status.***

***State Filing Requirements (Part IV, lines 17-19 and 21-22):*** The instructions indicate that some organizations may need to complete the schedules to conform with state filing requirements, even though they are not required to do so by the IRS. It would be helpful to include this information in the general highlights as well.

***Non-cash Contributions (Part IV, lines 29-30):*** We found these instructions somewhat confusing and encourage the IRS to direct the reader to the instructions to Schedule M and the glossary for definitions of terms and more detailed discussion of how to establish the value of non-cash contributions. We also note that there is not any definition or discussion of “contributions to the capital of the organization”, a term which we did not understand.

***Related and controlled entities (Part IV, lines 33-35):*** These instructions were also somewhat confusing for organizations that are unfamiliar with the concepts of related and controlled entities, although there are definitions of these terms in the glossary. We encourage the Service to add a chart to the instructions (or provide a reference to a chart on its website) that details the various types of related entities.

### **Other IRS Filings (Part V)**

This section provides a good opportunity to educate exempt organizations about reporting obligations with which they may be unfamiliar. It would be helpful if the general highlights for Part V provided a specific reference to the excellent materials on the IRS website, particularly the “life cycle” charts, to help users who are unfamiliar with the different forms referred to in this section that they may be required to file. Also, since in other parts of the Form leaving a blank line could mean filing an incomplete return, we believe the instructions should make it clear for Part V that it is appropriate to leave a line blank if the line is not applicable to the organization.

The instructions for ***line 5, prohibited tax shelter transactions***, are especially important in educating charitable organization managers who may unknowingly become a party to a prohibited tax shelter transaction. ***We recommend that the IRS include information about where filers may find clear, up-to-date, readily accessible information on listed and other reported transactions to enable them to determine whether a transaction is potentially abusive or prohibited, and whether they are under an obligation to disclose participation in the transaction.***

The instructions for ***line 8, disclosure of excess business holdings***, need to include a definition of “excess business holding” or such a definition should be provided in the glossary. The explanation for “donor advised funds” notes that such a fund “is treated as a private foundation,” but the uninformed reader may not be aware of how private foundations are treated or how this may apply to their organization. We believe that phrase should either be deleted or explained. This also applies to the instructions for ***line 9, taxable distributions***, a term which is not yet defined in either the instructions or the glossary. In the editing process, the IRS should combine and clarify both lines 8 and 9 since there is much similarity in these two areas.

The IRS rightly repeats the instructions for 501(c)(12) organizations from the instructions for line 87 of the current Form 990; we recommend that the IRS also repeat the instructions for 501(c)(7) organizations from the instructions for line 86 of the current Form 990.

### **Governance, Management, and Disclosure (Part VI)**

***Independence of Board Members (Part VI, line 2):*** The definitions of independent board members provided in the instructions are clear, and provide helpful clarification about particular circumstances that would not cause a board member to lack independence. Nonetheless, we expect that there will be many questions from charitable organizations

regarding whether certain board members are independent, e.g., does owning stock in a company from which the organization purchases goods or services constitute receiving an indirect material financial benefit from the organization? We believe that examples 2 and 3 in the instructions for Part VII, line 5, provide a useful starting point for examples of independence: attorney C in example 2 would be independent; whereas director D in example 3 would not be independent. We are happy to work with the Service and other nonprofits to provide further clarification on this issue in the future.

***Definition of family relationships:*** The definition here is not consistent with the definition provided in the glossary or the definition provided in the current Form 990 (lines 51 and 75b). It would be helpful for the filer and the reader if these definitions were made uniform.

***Delegation of management to a management company (line 3):*** It is not clear whether the IRS intends to capture situations where an organization outsources some part of its management functions, but retains overall management authority. For example, Community foundation A may handle investments for other community foundations set up as supporting organizations to A. Should the supporting organizations answer “yes” to this question? Public charity B uses an outside accounting firm to issue checks and prepare its financial records. Should it answer “yes” to this question? There are many other examples where an organization may outsource particular services, and we believe that further clarification in the instructions could alleviate confusion.

***Governing body review of Form 990 (line 10):*** Many boards of charitable organizations delegate responsibility for review of the Form 990 before filing to a separate finance, executive, or other committee made up primarily of members with the appropriate knowledge, rather than asking the full board to review the form before it is filed. Establishing the expectation that all board members will have an opportunity to review the Form 990 *before* filing could cause a greater number of organizations to request filing extensions and delay the receipt and availability of timely information. ***We recommend adjusting the instructions to permit organizations to answer “yes” if a copy of the organization’s final Form 990 was provided to a committee of the board or to all board members prior to its filing with the IRS.***

***Governance Policies (Section B, lines 12-16):*** The instructions state that the organization should state “yes” if it implemented whistleblower and document retention policies on or before the last day of the organization’s tax year, but it does not provide the same statement regarding a conflict of interest policy. ***We recommend that the instructions state that organizations that have adopted such policies prior to the date their returns are to be filed should respond “yes” to all of these questions.***

The example provided in the instructions for a “conflict of interest policy” (line 12a) is an example of a situation that is not a conflict of interest, but it is not an example of a conflict of interest policy. One organization’s policy may describe how to manage this type of conflict of interest in its policy, while another may not. Furthermore, the example draws

conclusions regarding B's material financial interest in the legislative proposal. *We recommend that the Service provide examples of conflicts of interest policies on its website that might help organizations understand how best to manage the conflicts that are inherent in the life of exempt organizations, and eliminate this example from the instructions.*

The "tip" regarding Sarbanes-Oxley legislation is a bit over-stated in that the statute imposes criminal liability for retaliation against whistleblowers who report federal offenses. On the other hand, there are many state laws that provide broader protection for whistleblowers at exempt and non-exempt organizations. This tip should be clarified in the final version of the instructions.

***Process for determining compensation (line 15):*** It would be helpful to provide in the instructions the definition of "conflict of interest" as it relates to this issue.

### **Compensation of Officers Directors, etc. (Part VII)**

The overview should state clearly that compensation should be drawn from the latest Form W-2 or 1099-MISC filed by the organization and all related organizations during or at the end of the filing organization's fiscal year. It should further clarify that this compensation may not agree with information reported in Part IX, Statement of Functional Expenses, if the organization does use a calendar-year fiscal year. It would also be helpful if the overview for Section A provided the description of reportable compensation rather than simply referring to the Schedule R instructions. Finally, the note on page 6 regarding common paymaster should be included in the highlights at the beginning of the instructions for this section.

***Definition of Key Employee:*** We believe that the definition of a "key employee" provided in the instructions for Part VII is overly broad and could require many larger exempt organizations to include several employees, imposing an unnecessary burden and diminishing the relevance of data for those who are in positions to have substantial authority over the organization's activities. As written, a key employee could be the curator of a particular collection within a museum, the manager of a relatively small department within an organization, a planned giving or development officer who brings in contributions in a single year representing more than 5 percent of the organization's annual revenues, and so on. *We recommend that instead the Service define a key employee by position (such as the chief administrative officer, the chief operating officer, and the chief financial officer). If the Service chooses to include other program or financial managers, the threshold for determining the extent of a key employee's control should be raised to at least 25%, following the standard set for the significant disposition of assets in Schedule N.*

In response to the Service's request for comments regarding whether organizations should be required to report deferred compensation for an employee in the year in which such compensation is earned or paid, we recommend that filing organizations be permitted to

choose either of these options, depending on the nature of their operations and the particular type of deferred compensation. In cases where the deferred compensation is subject to substantial forfeiture, the organization might determine that inclusion of deferred compensation before it is paid would overstate the employee's compensation. In other cases, the organization might feel that including the entire deferred compensation in the year in which it was paid or in which the employee is fully vested would provide a misleading impression of the employee's compensation in that given year.

### **Statement of Revenue (Part VIII)**

As noted earlier, we recommend that the Service only require organizations to provide activity codes from the *Codes of Unrelated Business Activity* for their non-exempt activities. We found the other parts of these instructions to be clear, and we especially appreciate the helpful clarification regarding membership payments and the distinctions between government contributions and contracts. It would be helpful if the note related to federated fundraising agencies provided on page 19 of the instructions for Part IX were included in the general instructions for Part VIII.

***Reporting of Non-Cash Contributions (Part VIII and Schedule M):*** The instructions to Schedule M clarify appropriate reporting methods for non-cash contributions based on the organization's record keeping practices, and we believe it would be helpful to repeat that clarification in the instructions for Part VIII, line 1, rather than the current statement that organizations must "report the value of non-cash contributions at the time it was received." We further commend to the Service's attention the comments of our member, the American Association of Museums, which provide additions and corrections to the instructions regarding Schedules B and M.

### **Statement of Functional Expenses (Part IX)**

The discussion of *how to allocate expenses* (page 13) indicates that filers should "not make any entries in column A for offsetting entries," but the example below it includes a negative entry in column A of \$5,000 for fundraising expenses. The instructions should be revised to indicate that organizations should not make offsetting entries in column A EXCEPT for [note the specific circumstances that apply].

***Lobbying fees (11d):*** The instructions should clarify the relationship between fees to be reported on 11d and 11g (amounts paid to an independent contractor for advocacy services that do not constitute lobbying). It is not uncommon for a 501(c)(3) organization to hire a legislative liaison who provides advice on congressional activities or regulatory items unrelated to lobbying, or monitors and acts on items included in self-defense lobbying.

***Professional fees (lines 11a-11g):*** For consistency, the instructions for all lines should indicate that these are for services provided by outside firms and individuals who are not employees of the reporting organization.

***Advertising (line 12):*** We continue to find the instructions regarding including

“amounts for the organization’s in-house fundraising campaigns” in this line both confusing and contrary to standard accounting practices for many organizations. Generally, organizations would report office expenses, travel, or conferences/meetings used in fundraising efforts under the respective line item under column (D). We do not see the value of requiring organizations to report these expenses differently for each column.

### **Balance Sheet (Part X)**

The instructions for the balance sheet are generally clear, but some of our members have noted that guidance is needed regarding methods to be used for establishing the value of intangible assets (line 14) such as goodwill, mailing lists, etc.

### **Comments on Schedules**

The instructions for Schedule A provide very helpful information on the different types of charitable organizations and distinctions between types of supporting organizations. We think it would be helpful if the description of “gross receipts from related activities, etc.” include the clarification of how membership fees that are payments to purchase admissions, merchandise, services or the use of facilities in a related activities for both Part II (organizations exempt under 170(b)(1)(A)(iv) and (vi)) and Part III (organizations exempt under 509(a)(2)).

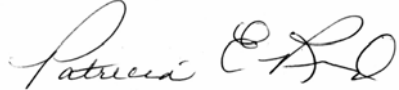
We have not yet gathered recommendations from our members regarding which countries ought to be included in the regions identified under **Schedule F**. Given that organizations currently use different regional groupings, we recommend that the IRS permit organizations to use their own groupings for the first filing year, rather than impose a new grouping that has not yet been determined.

As noted earlier, we appreciate the greater clarity provided in the instructions for **Schedule M**, but we commend the comments offered by the Association of American Museums to the Service’s attention. We further recommend that the instructions regarding **Non-standard contributions (line 31)** be expanded to include two other conditions identified in Notice 2007-72, that is, (c) items where the charity has agreed not to transfer its interest for a period of time; or (d) items where the charity has agreed to sell its interest to a party selected by or related to the donor.

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We thank you again for your efforts to reach out to the nonprofit community to make the revised Form 990 a more effective tool to strengthen compliance and accountability of all exempt organizations. We look forward to working with you as you continue to improve the instructions to the Core Form and Schedules and educate exempt organizations about using the new Form in making their annual reports. Please contact me at 202-467-6147 or [pat@independentsector.org](mailto:pat@independentsector.org) for further assistance.

Sincerely,

A handwritten signature in cursive script that reads "Patricia Read".

Patricia Read  
Senior Vice President, Public Policy and Government Relations  
Independent Sector