Bond Case Briefs

Municipal Finance Law Since 1971

AICPA Comments on EO Information Return.

Jeffrey Porter of the American Institute of Certified Public Accountants has submitted comments on Form 990, "Return of Organization Exempt from Income Tax," and instructions, suggesting changes to the 2014 form and instructions.

October 25, 2013

Mr. Ken Corbin

Acting Director, Exempt Organizations

Internal Revenue Service

1111 Constitution Avenue, N.W.

Washington, D.C. 20224

RE: Comments on Form 990, Return of Organization Exempt from Income Tax, and Instructions

Dear Mr. Corbin:

The American Institute of CPAs (AICPA) is pleased to provide comments on Form 990, Return of Organization Exempt from Income Tax, and instructions. Our matrix includes comments and recommendations for the 2014 forms and instructions, while indicating the importance and urgency of each recommendation.

The comments were developed by the AICPA Exempt Organizations Taxation Technical Resource Panel (TRP) and approved by the AICPA Tax Executive Committee. The Exempt Organizations TRP is comprised of practitioners who serve tax-exempt organizations and are experienced with both the nuances of the form and the challenges that arise for taxpayers in trying to complete it.

The AICPA is the world's largest member association representing the accounting profession, with more than 394,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-fo--profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our comments, and look forward to working with you in the future on this matter. We are available to meet with you to discuss and explain our comments further. If you have any questions, please contact Jeanne Schuster, Chair, AICPA Exempt Organizations Taxation Technical Resource Panel, at (617) 585-0373, or jeanne.schuster@ey.com; or Amy Wang, AICPA Technical Manager, at (202) 434-9264, or awang@aicpa.org.

Sincerely,

Jeffrey A. Porter, CPA

Chair, Tax Executive Committee

American Institute of CPAs

Washington, DC

* * * * *

General Instructions

Section of the Form

Instructions, Foreign Filings & Public Disclosure

Importance/Urgency

Low

Comment

If a foreign form (Form 926, 5471, etc.) is attached to Form 990 instead of Form 990-T, the instructions do not address whether it is open to public disclosure. Currently, GuideStar does not appear to publish these forms when they are filed with a Form 990. The instructions make it clear that if the foreign forms are filed with Form 990-T, they are then removed for public disclosure purposes.

Recommendation

Please clarify that foreign forms are removed from the public disclosure copy of the Form 990.

Section of the Form

Instructions, Section E, When to File

Importance/Urgency

Low

Comment

It is understood that an organization that has an application for exemption pending must file Forms 990-EZ, 990-PF, or 990 while its application for exemption is in pending status. Currently, it is unclear whether and when an organization that has an application for exemption pending must file a Form 990-N. In addition, if the organization is not yet in the IRS system and cannot file a Form 990-N, the instructions do not address whether or not the organization must file a paper extension until it can get into the IRS system and file a Form 990-N.

Recommendation

Clarify in the instructions whether an organization must file an extension for a Form 990-N. Because the extension period might expire before exemption is granted, allow organizations whose exemption is pending and if granted on a retroactive basis to qualify to file a Form 990-N. An exemption pending box can be added to the form. In the alternative, provide guidance regarding the Form 990-N extension process.

Section of the Form

Instructions, Section H, Failure to File

Importance/Urgency

Low

Comment

If Forms 990, 990-EZ, 990-PF, or 990-N has been filed late, but within a three-year period, the instructions do not address whether this occurrence counts as a filing within three consecutive years for purposes of the automatic revocation provisions.

Recommendation

Clarify in the instructions that one return filed within three consecutive years qualifies as a filed return, even if late, except if the late return is for the third year and no return was filed for the previous two years.

Section of the Form

Instructions, Who Must File, Subcategory, Form 990-N

Importance/Urgency

Low

Comment

Small organizations need to maintain proper donor records in order to know when they have reached the filing threshold for a Form 990-EZ or full Form 990.

Recommendation

The instructions should note that all small organizations should keep track of their charitable contributions by donor. Once the filing thresholds have been reached for filing a Form 990-EZ, the organizations will have the appropriate documentation in order to file the Form 990-EZ and related Schedule A.

Heading, Part I and II

Section of the Form

Part I, Line 16a, Glossary

Importance/Urgency

Medium

Comment

This line requires organizations to report any “professional fundraising” paid to officers, directors, trustees, key employees or disqualified persons from Lines 5 and 6 of Part IX. These amounts are then excluded from Part I, Line 15.

Recommendation

The Internal Revenue Service (IRS) should clarify the definition of professional fundraisers as it relates to IRS appointed officers who are really employees (CEO, CFO, etc.). The definition for professional fundraising should include details for such individuals since employees are excluded from this definition.

Part III

Section of the Form

Part III, Line 4e

Importance/Urgency

Low

Comment

Currently, taxpayers have to manually calculate the total grants and program revenue for Lines 4a-4d to make sure the total amounts match with Parts VIII and IX of the return.

Recommendation

In addition to having the total program service expenses on line 4e, please add the total grants and program service revenue.

Part IV

Section of the Form

Part IV, Line 25a and Schedule L, Part I Header

Importance/Urgency

High

Comment

The excess benefit rules apply to section 501(c)(29) organizations. The updated form and instructions need to include these organizations.

Recommendation

Add section 501(c)(29) to the list of affected organizations on the face of the form at Part IV, Line 25a. The section 501(c)(29) organizations were appropriately added to the instructions.

Section of the Form

Part IV, Questions 12a and 12b

Importance/Urgency

High

Comment

The language in the instructions continues to confuse taxpayers and paid preparers. The source of the confusion comes from the definition in the Glossary for generally accepted accounting principles (GAAP). The definition as stated in the Glossary appears narrower than intended. There are audited financial statements with formal opinion letters for financial statements that are not prepared according to U.S. GAAP (e.g., cash-basis accounting, International Finance Accounting Standards (IFRS), hybrid accounting, etc.). Exempt organization taxpayers would like to answer “yes” to this question because an answer of “no” confuses their stakeholders.

Recommendation

One option is to remove the reference to GAAP from both the instructions to Line 12 and the Glossary (but keep audited financial statements). A second option is to re-write the definition of GAAP in the Glossary to allow for other methods of accounting, including but not limited to cash-basis, modified cash-basis and IFRS.

Section of the Form

Part IV, Line 29

Importance/Urgency

High

Comment

The question posed is whether the organization received more than $25,000 in non-cash contributions. If the answer is “yes,” Schedule M needs completion. The instructions also provide that contributions of services or use of facilities are not included. Line 33 of Schedule M asks to include a description in Part II if the organization did not report an amount in Column (c) for a type of property for which Column (a) is checked. The instructions ask for an explanation of why the organization did not report revenue for the item. Since in many instances, it is likely that organizations will not take into account contributions where no revenue has been recorded, the answer to Line 29 may be “no” and result in Line 33 of Schedule M having no response.

Recommendation

To make certain that Line 33 of Schedule M contains a response where relevant, Line 29 presentation on the form, as well as the instructions, need revising to make clear that the $25,000 threshold is regardless of whether amounts were included in the financial statements or in financial statement revenue. The question can include a parenthetical to allow the form to read: “Did the organization receive more than $25,000 in non-cash contributions (whether or not included in revenue)?”

Part V

Section of the Form

Part V, Line 2a

Importance/Urgency

Medium

Comment

Please clarify whether the number of employees paid by a related exempt organization must be indicated at this line if the related organization files the W-2s and W-3s while the employee works for the filing organization. If the employee is included on the filing organization, the instructions should indicate whether he/she is also included on the related organization because it was the related organization that issued the W-2. If the answer is yes, double reporting will presumably occur as both organizations will include the employee on this line of the Form 990.

Recommendation

Clarify whether or not to report an employee more than once. In addition, clarify whether the number on this line has any correlation to the salary expense reported on Part IX. For example:

Organization P is the parent and common paymaster for Organizations S and T. Therefore, all payroll related activities run through Organization P. Employee X is an employee of Organization P. However, he/she spends 20% of his/her time with Organization S, 30% of his time with Organization T and the remaining 50% with Organization P. While Organization P pays for all of Employee X's salary and related payroll expenses, Organizations S and T reimburse P for the amount of time Employee X spends at their organization. Therefore, Organizations S, T, and P each report 20%, 30% and 50% respectively of Employee X's salary on their Part IX.

Please clarify whether the procedure should be: 1) Organizations S, T, and P report Employee X on their Part V, Line 2a because Employee X works for all three organizations, or 2) Only Organization P report Employee X on Part V, Line 2a because Organization P is the one the issued the W-2 to Employee X.

Section of the Form

Part V, Line 2a

Importance/Urgency

Low

Comment

The face of the form indicates an organization should report the number of employees on its Form W-3 for the year. However, the instruction for this line indicates this number is the organization's number of employees.

Recommendation

Please change the language on either the core form or the instructions in order for the two questions to ask for the same number.

Part VI

Section of the Form

Part VI, Line 15

Importance/Urgency

Medium

Comment

The last paragraph of the instructions for Line 15 indicates that if the filing organization did not compensate its CEO, executive director, other officers, or key employees, it should answer “no” to Lines 15a and 15b. However, the instructions do not address what the answer is if the filing organization itself did not compensate those employees but a related organization or common paymaster did. Some organizations take this question literally and answer “no” because they themselves do not compensate the employees despite having these types of individuals’ compensation reported in Part VII, Column (D).

Recommendation

Clarify that an organization should only answer “no” if no compensation was paid to these individuals whether by the filing or related organization.

Section of the Form

Part VI, Line 15

Importance/Urgency

Medium

Comment

The instructions to Line 15 state that an organization should answer “yes” if the organization used a process for determining compensation of those individuals listed in Part VII. What if the filing organization relied on its parent or related organization to determine the compensation and the filing organization itself does not have a process? The instructions do not clearly explain whether the filing organization must have its own process or whether it can rely on a related organization’s process.

Recommendation

Clarify whether filing organizations must have their own processes to determine compensation or whether they can rely on a related organization’s process to determine the filing organization’s compensation and still check “yes.” Also, include an additional subpart below Line 15 to have a box checked if: “Process was performed by a related organization.”

Section of the Form

Part VI, Line 1a

Importance/Urgency

Low

Comment

The form indicates a disclosure is required if the organization delegates broad authority to an executive committee. However, “broad authority” is not defined. Almost all organizations delegate some powers to the executive committee.

Recommendation

Please provide examples of decisions that qualify and do not qualify under “broad authority.” For example, it is our opinion that the authority to approve compensation of executives is not considered broad authority, but hiring/firing executives is considered broad authority.

Part VII

Section of the Form

Part VII, Section B

Importance/Urgency

High

Comment

The instructions add disclosures for organizations using management companies such as contract CFO services. However, the instructions lack specificity as to what is disclosed regarding compensation. It is common for individuals to work for a company that provides contract CFO services to organizations. Those individuals are assigned to perform work for multiple organizations throughout the year. Their compensation from the management company may not be allocated to the individual clients easily. Also, those individuals may not want to disclose how much they are compensated by their employer, especially if it is not solely related to services provided to the reporting exempt organizations.

Recommendation

Expand the instructions to specify that the compensation is for the calendar year ending with, or within, the calendar year to match other similar disclosures on the Form 990. The instructions should permit the disclosure of an allocated amount rather than the full amount paid by the management company to the individual and also, allow for a reasonable estimate if actual amounts are not available.

Section of the Form

Part VII, Section B

Importance/Urgency

Medium

Comment

Suppose a parent organization pays a vendor on behalf of a related subsidiary organization, and the subsidiary reimburses the parent for the expenses. Instructions are needed to explain which organization (parent or subsidiary) should report the expense if the vendor is paid greater than

$100,000.

Recommendation

When one organization is paying expenses on behalf of another organization, please clarify which organization should report the payment on Part VII, Section B.

Part VIII, IX, X and XI

Section of the Form

Part VIII, Line 8b (and Schedule G, Part II, Direct vs. Indirect Expenses)

Importance/Urgency

Medium

Comment

There is confusion surrounding what is classified as a “direct expense” versus “indirect expense” for special events. Postage, invitation costs, and securing sponsorships all occur before the day of the event but directly relate to the event. However, many taxpayers work under the logic that “direct expenses” really mean “day of event” and “indirect expenses” really mean “pre-day of event.” In addition, for most taxpayers, there is significant administrative burden in separating out the expenses of an event into those two categories.

Recommendation

Please specify the appropriate indirect expenses to list in Part IX of Form 990.

Section of the Form

Part XI, Line 6, Instructions

Importance/Urgency

High

Comment

The instructions are incorrect. This line is for donated services and use of facilities. However, the instructions indicate it is the sum of Lines 3, 4, and 5.

Recommendation

Two recommendations:

1) The instructions should explain that this line is an item that requires an entry and it is not the sum of the lines above. For better transparency, require detail of the income and expenses for donated services and use of faculties on Schedule O, or

2) The second option is to separate Line 6 into Line 6a) Revenue from donated services and use of facilities, and Line 6b) expenses from donated services and use of faculties. Separating revenue and expenses can provide greater transparency. Sometimes, these amounts will equal, and in that case,

the number nets to zero.

Schedule B

Section of the Form

Schedule B, Page 1, Special Rules

Importance/Urgency

Medium

Comment

Per Treas. Reg. 1.6033-2(a)(2)(iii)(a), an organization described in section 501(c)(3) which meets the 33 1/3% of support test of the regulations under section 170(b)(1)(A)(vi) (without regard to whether such organization otherwise qualifies as an organization described in section 170(b)(1)(A)) is required to provide the name and address of a person who contributed, bequeathed, or devised $5,000 or more during the year only if this amount exceeds 2% of the total contributions, bequests and devises received by the organization during the year.

Recommendation

Please clarify if an organization that meets the section 509(a)(1) test and the section 170(b)(1)(A)(vi) test but is not granted exempt status under section 170(b)(1)(A)(vi), such as a school or hospital, the organization is still able to use the special rule for Schedule B.

Schedule C

Section of the Form

Schedule C, Part II, Page 1, Instructions, Column 2

Importance/Urgency

High

Comment

The instructions state: “for which the election was valid and in effect for its tax year beginning in the year 2011.” This language is only correct for fiscal year organizations. For calendar year organizations, the tax year will begin January 1, 2013 and an election made in that year is valid and effective for 2013.

Recommendation

Please correct the instructions to use the appropriate date in future forms.

Schedule D

Section of the Form

Schedule D, Part I, Other Funds

Importance/Urgency

Medium

Comment

Some taxpayers are not including scholarship funds in Column (b) as “funds or other accounts.”

Recommendation

Please add an example or clarification to the instructions regarding whether scholarship funds meet the definition of “funds or other accounts.” Also, add language to clarify that Part I should report “funds or other accounts,” which are part of the endowments (reported in Part V).

Section of the Form

Schedule D, Part V, Endowments, Lines 1 and 4

Importance/Urgency

Low

Comment

Consider changing the instructions to only reflect endowments for the filing organization rather than those endowments held by a related organization. It is duplicate reporting by the parent organization when the related organization holds the endowments. Additionally, it can cause confusion to the tax preparer if an endowment is reported in Part V of Schedule D but no investment assets appear on the filing organization’s balance sheet.

Recommendation

Change instructions to only require Line 1 reporting of endowment funds when held by the organization. Change Line 4 to say, “Describe in Part XIII the intended uses of the organization’s endowment fund. Also, if `yes’ to Lines 3(a)(i) or 3(a)(ii), name the organization(s) in Part XIII.”

Schedule F

Section of the Form

Schedule F, Part I

Importance/Urgency

Medium

Comment

Due to the amount of ownership in a program related investment (PRI), activities of the PRI can consolidate on the exempt organization’s financial statements. In this case, the assets, liabilities, and equity of the PRI are reported on the exempt organization’s return.

Recommendation

Please clarify whether the amount reported on Schedule F, Part I, Line 3(f) is the total assets of the PRI or total equity balance of the PRI. The instructions indicate the ending book value is reported. It is not clear if this value is the net equity balance or total asset balance.

Section of the Form

Schedule F, Part IV, Question 1

Importance/Urgency

Medium

Comment

Schedule F, Part IV, Question 1 states: “Was the organization a U.S. transferor of property to a foreign corporation during the tax year? If ‘Yes,’ the organization may need to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation (see Instructions for Form 926).” Based on conversations with the IRS, the answer to this question is “Yes” if the organization made grants to foreign organizations that are corporations. We believe that this question is answered “Yes” when the organization has made grants to foreign corporations.

Recommendation

The IRS should make it clear in the instructions that the “transfer of property” to a U.S. corporation for these purposes does not include grants. Grants are already disclosed on Schedule F, Part II, and a grant is not the type of transfer that triggers a Form 926 filing. Therefore, this question is redundant for grants. Responding “Yes” for grants will also make it difficult for the IRS to determine whether the organization may have a Form 926 filing requirement.

Schedule G

Section of the Form

Schedule G, Part II, Direct vs. Indirect Expenses (and Part VIII, Line 8b)

Importance/Urgency

Low

Comment

There is confusion surrounding what is classified as a “direct expense” versus “indirect expense” for special events. Postage, invitation costs, and securing sponsorships all occur before the day of the event but directly relate to the event. However, many taxpayers work under the logic that “direct expenses” really mean “day of event” and “indirect expenses” really mean “pre-day of event.” In addition, for most taxpayers, there is significant administrative burden in separating out the expenses of an event into those two categories.

Recommendation

Please specify the appropriate indirect expenses to list in Part IX of Form 990.

Schedule I

Section of the Form

Schedule I, Parts II and III

Importance/Urgency

Medium

Comment

Taxpayers continue to have confusion about what qualifies as cash vs. non-cash. The instructions provide examples of tangible non-cash items such as equipment and supplies. However, there are many other types of grants being made where the recipient receives a financial benefit but never has access to cash. For example, gift cards are generally considered cash equivalents. However, organizations may receive the benefits from gift cards but never have access to cash.

Recommendation

Please add the following as examples of non-cash contributions for Schedule I purposes: 1) Financial aid and scholarships that are applied against a student's tuition account 2) Gift cards to individuals for necessities such as groceries, household items, etc. 3) Payments to a third party vendor on behalf of an individual (e.g. paying the utility company for a family in need).

Schedule J

Section of the Form

Schedule J, Part I, Line 4a

Importance/Urgency

High

Comment

The question asks whether a person listed in Part VII, Section A, Line 1a with respect to the filing or related organization has received a severance or change-of-control payment. The instructions provide that "a severance payment is a payment made if the right to the payment is contingent solely upon the person's severance from service in specified circumstances, such as upon an involuntary separation from service." The utilization of the phrase "such as upon involuntary separation" is reasonably interpreted as illustrative, and not exclusive. The language that is used causes uncertainty as to whether voluntary separations are also within the purview of the instructions.

Recommendation

In order to eliminate any uncertainty as to the types of separation payments disclosed, please clarify whether separation pay includes voluntary separation payments.

Section of the Form

Schedule J, Part VII, Listing of Trustees and Officers on Part VII and on Schedule J

Importance/Urgency

High

Comment

Neither the form nor the instructions forbid listing the same person on more than one line.

Recommendation

To avoid confusion to the reader with the use of multiple lines for one individual, the form and instructions should state that all compensation to one individual should be listed only once and not broken into multiple individual listings.

Section of the Form

Schedule J, Header Above Line 5

Importance/Urgency

Medium

Comment

The header and instructions indicate that the following questions only apply to organizations exempt under section 501(c)(3) and (4). Instructions are needed to explain if section 501(c)(29) organizations are added to this list.

Recommendation

Consider adding section 501(c)(29) organizations to the list of organizations required to complete this part of Schedule J.

Schedule K

Section of the Form

Schedule K, Part III, Line 7, Instructions

Importance/Urgency

High

Comment

The new question on the 2013 Schedule K asks about the private security or payment test of section 141(b)(2) but provides no additional definitions.

Recommendation

Please add a definition for “private security test” and “private payment test” to the Schedule K instructions and glossary.

Schedule L

Section of the Form

Schedule L, Part I, Header

Importance/Urgency

High

Comment

Section 501(c)(29) organizations are also subject to excess benefit transaction rules. This information is missing from the header.

Recommendation

Modify the header to include section 501(c)(29) organizations.

Section of the Form

Schedule L, Part IV

Importance/Urgency

High

Comment

For purposes of Part IV, the list of interested persons includes an entity other than a section 501(c)(3) organization, a section 501(c) organization of the same subsection as the filing organization, or an entity more than 35% controlled by one or more current directors. Consider the following example: Organization A (501(c)(3)) owns 100% of Corporation B. The officers of B consist entirely of directors from A. B has business transactions with A in excess of $100,000. As the instructions are currently written, the transactions are reported on Part IV, and all directors of B are treated as not independent with respect to A. Since A owns/controls B, A can do what it wants with B (e.g., liquidate, merge, etc.). It does not make sense that those board members are deemed to lack independence with respect to A.

Recommendation

Add the following to the list of exceptions: Business transactions with an organization controlled by the filing organization.

Schedule M

Section of the Form

Schedule M, Column C

Importance/Urgency

Low

Comment

A “total” line is needed to sum up the amounts in Column C in order for the Schedule M contribution detail to easily agree back to Part VIII, Line 1g of the Form 990.

Recommendation

Please add a “total” line to sum up the amounts in Column C.

Schedule N

Section of the Form

Schedule N, Part II

Importance/Urgency

Medium

Comment

The instructions need greater clarification regarding what types of transactions are excluded. It is logical that a sale of investment assets for fair market value consideration in order to pay down debt is not the kind of transaction that would require a Schedule N disclosure. However, the instructions appear to require this disclosure.

Recommendation

Add to the examples of situations that are not reporting requirements: “Sale of investment assets such as securities for full fair market value consideration for any purpose.”

Schedule R

Section of the Form

Schedule R, Instructions

Importance/Urgency

Medium

Comment

The definition of control of a nonprofit (as defined in the Glossary to the Form 990) includes the following statement: “Also, a (parent) organization controls a (subsidiary) nonprofit organization if a majority of the subsidiary’s directors or trustees are trustees, directors, officers, employees, or agents of the parent.” This definition of control includes situations where there is coincidental overlap (i.e., there is no right or ability of one organization to appoint or remove board members of the other). While the organizations may be related, there lacks a sense of an element of control in these situations.

Recommendation

At conferences and in conversations with the IRS, IRS personnel have indicated that there is coincidental overlap when each organization is the controlled and controlling entity. With coincidental overlap, there is no control. This presentation on the Form 990 may confuse readers from understanding the true nature of the organizations’ relationship. The IRS should modify the instructions to state that in cases where there is coincidental overlap of board members, each organization should report the other entity as “related” using Schedule R. However, neither organization is a controlled or controlling entity.

Section of the Form

Schedule R, Definitions

Importance/Urgency

High

Comment

It is a challenge to determine “brother/sister” organizations in large organizations with complex structures and multiple layers of organizations. Additional examples of the extent/reach of Schedule R reporting are helpful. The following examples and questions illustrate the issue. Example: A and B (brother/sister organizations) are commonly controlled by C (the parent). D is a supporting organization of A. B owns 100% of E, a for-profit C corporation. Should D report on B’s Schedule R? Should E report on A’s Schedule R? Should E report on D’s Schedule R? A and B have separate boards, but all board member are appointed by C. No board members of B are on D’s board. None of the officers of E are part of A or D’s boards. However, C directly or indirectly controls all of the organizations. This issue becomes more pronounced when dealing with a Catholic hospital system or state university system. It is quite burdensome to locate every controlled for-profit subsidiary and/or partnership. Reasonable efforts should apply.

Recommendation

Please provide an example in the instructions with similar facts as this AICPA provided comment. Please also allow for reasonable efforts.

Section of the Form

Part IV

Importance/Urgency

Medium

Comment

The definition of control for trusts is ownership of more than 50% of the beneficial interest in the trust. More clarity is required with regards to split interest trusts. It appears that many split interest trusts will need reporting (if the beneficial interest is more than 50%) even though the filing organization has no actual control over the assets or distributions of income.

Recommendation

Exclude the reporting requirement for trusts for which there is an outside unrelated trustee and a trust document that gives the beneficiary no control.

Section of the Form

Part V, Line 2

Importance/Urgency

High

Comment

It is extremely burdensome for organizations to gather this information and ensure consistency amongst related organizations. Not all members of related groups utilize the same tax preparers.

Recommendation

Eliminate the detailed reporting on Line 2 or limit the request to just a few specific transactions such as: controlled group interest, annuities, royalties, and rent.