American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

August 9, 2011

Mr. Stephen Clarke
Internal Revenue Service
SE:T:EO (3C1)
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Comments on Announcement 2011-36

Dear Mr. Clarke:

The American Institute of Certified Public Accountants (AICPA) is pleased to provide comments on Announcement 2011-36 to the Internal Revenue Service (IRS) on transitional issues and frequently asked questions involving the redesigned Form 990, *Return of Organization Exempt from Income Tax*. These comments were developed by our Exempt Organizations Tax Technical Resource Panel and approved by our Tax Executive Committee.

The AICPA is the national professional organization of certified public accountants comprised of approximately 370,000 members. 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-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

**1. Activity codes**

The IRS is considering removing the spaces in Part III for reporting activity codes. Due to the limitations and constraints noted by the IRS, the AICPA agrees that eliminating the reporting of activity codes is preferable to the adoption of a coding system. Too often, organizations resort to using the default code when another, more appropriate code that reflects the true nature of the organization's activities, is not available. Widespread use of a default negates the benefit of the coding system. We also agree that existing systems do not adequately reflect the wide range of program service activities provided by tax-exempt organizations.

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

The IRS is requesting comments on how a filing organization's payments to management companies and other third parties for an ODTKE's services should be reported on the Form 990. As described in more detail below, the AICPA makes the following recommendations: 1) Request a narrative disclosure providing additional general information about an organization's management company arrangements,

either in a separate section of Part VII or in Schedule O; 2) Remove the "common law employees under state law" concept from the Form 990 instructions; and 3) Clarify compensation reporting requirements for organizations whose employees are supplied by an employee leasing company, known as Professional Employer Organizations (PEOs) and non-independent (i.e., "related") management companies.

*Narrative Disclosure*

The AICPA believes that the current compensation reporting requirement is sufficient for Part VII, and that the current instructions for reporting compensation for executives employed by independent management companies under "Management companies" on page 26 should be retained. However, the AICPA thinks that a narrative disclosure providing additional general information about an organization's management company arrangements, either in a separate section of Part VII or in Schedule O, would increase transparency and clarity, especially regarding an organization's specific use of a specific type of management entity. Management companies and PEOs provide distinctly different services, and a section for a narrative description of type and scope of services provided would be enlightening to the Form 990 user.

*Unrelated Third-Party Association Management Companies*

The IRS' purpose for initiating the original disclosure requirement was to capture compensation information for organization managers employed not by the organization itself, but by a related management company. Implicit in this new requirement was a perception that some exempt organizations have set up separate management companies in an attempt to avoid reporting excessive compensation. While the AICPA understands that "bogus" management companies exist, the AICPA also understands that a far more common circumstance is one in which an exempt organization hires an unrelated third-party vendor, an association management company (AMC), to manage its day-to-day affairs. A 2006 survey[1] of trade and professional associations that are managed by an association management company yielded approximately 4,600 organizations utilizing the services of some 675 AMCs. These organizations amounted to 15% of the roughly 31,000 section 501(c)(6) business league, professional, and other associations that filed Forms 990 or 990-EZ for 2006.[2] Additionally, other not-for-profit organizations not included above - such as charities (including chapters of national organizations) - likely engage AMCs for management services. AMCs are attractive to small exempt organizations in particular, as small entities have limited resources and therefore limited ability to directly hire qualified management personnel. Also, very small organizations may not require full-time managers, and thus use AMCs for part-time management services.

The AICPA believes the greatest argument against expanded Part VII compensation reporting for management company payments is grossly distorted compensation reporting. The 2008 Form 990 revision seeks to provide greater transparency with regard to payments made to the individuals managing an exempt organization. An assumption in requiring reporting appears to be that management company fees effectively equal the compensation paid to the executives provided by a management company, i.e.,

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[1] AMC Institute Report, 2006. http://member.amcinstitute.org/newsroom/facts.cfm.

[2] Statistics of Income Bulletin, Fall 2009.

that an AMC collecting $250,000 in management fees, for example, would simply pay that $250,000 over to the management personnel it provides to that organization. In reality, AMCs provide a broad range of services for the fees they collect, of which executive management is merely a fraction. As discussed further below, obtaining the information to calculate that fraction would be extremely difficult.

Full-service AMCs typically assist organizations with one or more of the following services: management services; membership communications; membership processing; financial services; member, board, and committee meetings; web services; education; government affairs; and standards development and accreditation. For small organizations, AMCs may provide office facilities and meeting space. In addition to executive services, an AMC usually provides additional staffing, such as the services of a meeting planner, a publications editor, or a web site designer. AMC fees also take into account overhead (rent, equipment leases, maintenance contracts, office supplies, licenses, insurance, etc.) and "pass-through" expenses (telephone, fax, copying, postage, delivery, etc.). Furthermore, a typical AMC will provide services to many clients at once. An AMC-provided executive director, for example, may provide full-time management services for one association, or part-time services for several smaller associations that do not require full-time management.

For these reasons, any Form 990 reporting requirement that would attempt to tie management company payments directly to an executive's compensation, as suggested in Announcement 2011-36, would result in potential gross inflation and/or misstatement of compensation reported in Form 990, Part VII. Furthermore, it would provide the Form 990 user with no sense of the breadth of services provided by the AMC for the management fee it was paid.

Additionally, any attempt to extract the executive compensation component from a management company payment would be difficult. Depending upon its management fee structure, an AMC may or may not track executive time on a per-project basis. Some AMCs have an exhaustive fee schedule that includes separate charges for separate services; other AMCs simply charge a flat fee that may or may not be based on time incurred. For example, some AMCs base fees on the number of members served; others may under-price fees, hoping to make up the difference in the provision of extra services or in future fee increases. In summary, AMCs determine fees on widely variable bases, so in most instances it is difficult, if not impossible, for an exempt organization or even the AMC itself to calculate that portion of a management fee attributable to time spent by executive personnel. In such cases, any amount calculated would at best be an estimate, and at worst would bear little relationship to any executive services provided.

Furthermore, it will be impossible for an exempt organization to obtain executive compensation information, if neither the executive nor the AMC is willing to disclose it. Management contracts between an exempt organization and an AMC presumably are negotiated at arms' length and at fair value. It is not at all clear whether the management relationship would give the exempt organization access to otherwise private compensation information. While it is true that some exempt organizations have contracts with their AMCs that specifically list executive compensation, the majority do not, especially those who share the services of an executive director with several other organizations. These exempt organizations are not privy to the details of the various components (overhead, staffing, profit, etc.) that make up the management fees they are charged because there is no common ownership or control relationship between

the entities. It would be unfair to penalize an exempt organization for failure to obtain such information, under these circumstances.

*Leased Employees*

We recommend that the IRS remove the "common law employees of the filing organization under state law" concept from the instructions on "leased employees" under Part VII. This is widely perceived as confusing, because it seemingly alludes to the 20-factor test distinguishing employees from independent contractors, but instead references "state law," a murky standard which may vary by jurisdiction. A direct reference to the 20-factor test would be clearer, both for organizations and return preparers.

*Professional Employer Organizations*

The AICPA recommends that the IRS clarify compensation reporting requirements for PEOs. A PEO is considered to be a co-employer, sharing employment responsibilities with the contracting organization. A PEO, for example, pays wages and payroll taxes out of its own accounts, provides employee benefits, oversees human resource functions, and assumes responsibility for workers' compensation, labor law compliance and risk management. Both the PEO and the contracting company have the right to direct worksite employees, i.e., the PEO provides direction with regard to employment matters and the contracting organization oversees employee compliance with production and delivery of goods and services. Both the PEO and the contracting organization have the right, independent of each other, to hire and fire employees. This co-employment arrangement makes the PEO/exempt organization relationship clearly distinguishable from the AMC/exempt organization relationship, in which the exempt organization has no employer rights and in most cases has no knowledge of compensation amounts paid to the AMC's employees. Accordingly, we believe that PEO-paid ODTKE compensation is properly reportable on Form 990, Part VII and Schedule J, and request that the IRS makes this distinction in the Form 990 instructions.

*Organizational Affiliated ("Related") Management Companies*

The AICPA also requests more guidance with regard to the reporting requirements when executives work for an organizational affiliated management company. In this circumstance, exempt organizations generally have access to the executive's compensation information. However, it is not completely clear on what form/schedule such amounts should be reported. The AICPA recommends reporting amounts paid to executives working for related management companies similar to any other related organization in both Part VII and Schedule J.

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

The IRS has requested comments on whether some or all of the Form 990 compensation thresholds should be lowered, raised, or retained. The AICPA believes use of a single reporting threshold would achieve the appropriate balance between transparency and minimizing the administrative burden on organizations. Specifically, we suggest using the same threshold for the highest compensated employees as key

employees. We also suggest raising the threshold for former officers, key employees and highest compensated employees to the same limit. (However, we acknowledge an exception may be appropriate for former directors and trustees because of the potential scrutiny surrounding their relationships.)

The AICPA suggests raising the reporting threshold to $150,000. Currently, all persons who served as the organization's officers, directors and trustees during the year are reported regardless of compensation level. For other current and former key employees and highest compensated employees, we think that the substantial majority of employees that may be receiving excessive compensation would be reported with a threshold of $150,000.

4. **Reporting revenue from governmental units**

The IRS has requested comments on whether and how it should change the reporting requirements with respect to governmental funding. The AICPA thinks the reporting requirements with respect to governmental funding should be changed. In Announcement 2011-36, you also asked whether we support a revision to Part VIII, line 2 to itemize certain government payments, such as Medicaid and Medicare payments. We think such itemization (perhaps through descriptor lines) would be helpful to Form 990 users. We also support a revision to the instructions for line 1e to clarify that government contributions may include grants made pursuant to government contracts. Furthermore, we suggest expanding the examples provided in the Form 990 instructions to better clarify the classification required by the regulations.

While it is true that the instructions distinguish between the reporting of government funding as contributions or program service revenue based on whether the primary purpose is to benefit the public or provide a service to the governmental unit, the instructions do not provide sufficient guidance to make the appropriate distinction in many instances. To add to the confusion for many organizations, such government funding may be treated on their financial statements in a manner that is inconsistent with the treatment required on the Form 990. Prior to its revision, the Form 990 did require the itemization of certain governmental payments (Medicare/Medicaid and fees and contracts from government agencies). Nonetheless, the presence of such lines (other than Medicare/Medicaid) did not necessarily assist organizations in making the appropriate distinction. Treasury Reg. § 1.509(a)-3(g)(1) includes the following:

> Because of the imposition of terms and conditions, the frequent similarity of public purposes of grantor and grantee, and the possibility of benefit resulting to the grantor, amounts received as grants "for" the carrying on exempt activities are sometimes difficult to distinguish from amounts received as gross receipts "from" the carrying on of exempt activities.

The regulation sets forth distinguishing factors as well as several examples to illustrate the application of the factors. Although it may not be practicable to include the entire regulation and examples, the instructions should at the very least refer to the regulation. Notwithstanding the distinguishing factors provided, there are instances in which benefits seemingly flow from the governmental unit "for" the public's benefit, but are nevertheless characterized as program service revenue (e.g., Medicare/Medicaid

payments and Section 8 housing payments). With respect to Medicare/Medicaid payments, Rev. Rul. 83-153, 1983-2 C.B. 48,states that the "… purpose of Medicare and Medicaid programs is to ensure that aged, disabled, and financially needy individuals receive necessary and adequate health care." It also states that "… Medicare and Medicaid payments are primarily made to pay or reimburse for services already provided to individuals, rather than to encourage or enable an organization to provide services to yet unidentified members of the community at large." Thus, while such payments are provided by a government unit, the individual recipient is deemed to be the one who actually controls the ultimate recipient of the funds. Based on this analysis, the individual is deemed to be the payor, rather than the governmental unit.

Given the inherent ambiguity in distinguishing between governmental grants and gross receipts from program service revenue and the multiplicity of funding arrangements, we believe that the best approach would be to provide generally applicable principles and examples that can assist in making the distinction, as well as incorporating the analysis of Rev. Rul. 83-153.

**5. Net asset reconciliation**

The AICPA concurs that an asset reconciliation is needed in the core Form 990 and that it should remain as Part XI "Reconciliation of Net Assets" and deleted from Schedule D, Part XI "Reconciliation of Change in Net Assets from Form 990 to Audited Financial Statements" to avoid redundancy.

In addition, we would suggest a change in format to Part XI. We recommend that you replace Part XI, line 5 "Other changes in net assets or fund balances (explain in Schedule O)" with the following lines from Schedule D, Part XI:

4 "Net unrealized gains (losses) on investments"
5 "Donated services and use of facilities"
6 "Investment expenses"
7 "Prior period adjustments"
8 "Other (Describe in Part ___ ~~XIV.~~)" and
9 "Total Adjustments (net)"

This change would increase transparency by reducing the amount of information that is reported on Schedule O rather than on the face of the form.

**6. Reporting on audited financial statements**

The IRS has requested comments on whether any additional reporting of information regarding audited financial statements should be required. The AICPA believes that additional reporting on audited financial statements should not be required. The Form 990 already asks if the financial statements are audited, compiled or reviewed. The user of the form would likely assume that the follow-up question about consolidated versus separate financial statements would already be subject to that level of audit work. An additional question would serve no purpose and could confuse the user. Perhaps the IRS could

prepare a standard appendix to the Form 990 outlining the different levels of financial statement review to clarify how financial statements are audited.

On the matter of disclosing the type of opinion, many users may not understand the different levels of opinion and could easily be misled. Other than accountants, a user of the return who notices that the financial statements had an “unqualified opinion” could think that it was negative, when in fact it is the desired opinion. If this information will be required, we suggest a disclosure on Schedule O as opposed to a checkbox to provide the organization an opportunity to explain their opinion.

The questions on the return about financial statements are misleading to the public since the public is generally not familiar with the requirements to have an audit, review, compilation, etc. Since the IRS does not require financial statements to be audited and it is a matter of state law, which varies from state to state, asking for detailed information could cause smaller organizations that are not required to have an audit to appear unfavorable in comparison to a similar organization in another jurisdiction that may require it.

**7. Names and Employer Identification Numbers (EINs) of foreign grantees**

The IRS has requested comments on whether the two columns in Schedule F, Part II that request the name and EIN of each foreign grantee organization should be retained or deleted entirely. The AICPA suggests that this information be deleted entirely from Part II because disclosure could jeopardize the safety of such grantees, the filing grantor organization and its employees. In recognition of similar privacy and safety concerns, the IRS wisely limited the reporting of foreign reporting in Part I to disclosure of the region in which the organization has activities. To nonetheless require disclosure of grantee names and EINs in Part II, would similarly jeopardize the confidentiality of sensitive operations and the safety of such grantees. We prefer to delete Part II, columns (a) and (b) in their entirety. Some comments may suggest to merely exclude these columns from the public disclosure requirements. However, the AICPA believes such measures are insufficient given the potential risk involved.

**8. Indirect foreign expenditures**

The IRS has requested comments on whether Form 990 filers have developed procedures and adopted systems to separately track indirect foreign expenditures, and whether all Schedule F filers should account for and report indirect foreign expenditures in Part I, line 3, column (f). We do not believe that Schedule F filers are prepared to report indirect foreign expenditures.

The AICPA recommends not requiring tracking and reporting of indirect costs for foreign expenditures.
The tracking and reporting of such indirect costs for foreign expenditures will create an excessive administrative burden on many organizations. For example, one organization shared with the AICPA Exempt Organizations Tax Technical Resource Panel that for the 2009 tax filing, it was required to report per region travel expenses relating to conducting board meetings or sending representatives of the organization to attend and speak at seminars and conferences. This required a manual process of reviewing fifteen (15) travel-related expense codes in the general ledger and then further analyzing each code (approximately 25,000 individual expense lines) to determine which region was appropriate for the

individual line item expense. In the event that the general ledger system line item description did not provide sufficient information to determine the appropriate region of the expense, a person needed to review each individual expense report, purchase order or purchasing card documentation to determine the appropriate region. The effort of manually reviewing 15 expense codes and 25,000 expense line items took approximately 200 hours to complete. The effort that would be needed to examine the entire expense code list would be quite extensive.

For most organizations, it is not part of the strategic plan to explore a systematic effort that would potentially assist in the capturing of these indirect expenses. Absent a clear business objective, it would be hard to expend limited budget dollars on capital resources for such information gathering. The requirement of reporting indirect costs allocated to foreign activities does not enhance the transparency of such activities, nor does it further the IRS objective of transparency into exempt organizations.

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

The IRS is considering a requirement to report deposits and withdrawals from a bank account as a business transaction on Schedule L in tax year 2011. The AICPA believes this requirement is unnecessary, overly burdensome to the taxpayer, and potentially very misleading to the Form 990 user.

Transactions of this type are in the ordinary course of business and would be conducted regardless of the banking institution. We think the gathering of the data and the reporting requirements would be extremely burdensome for exempt organizations as large organizations could have daily transactions in excess of the reporting thresholds. Finally, the imposition of this burdensome information reporting requirement on exempt organizations cannot be justified in terms of the limited utility such information would provide to the government.

The underlying purpose of Schedule L is to report potential benefits to interested persons. In a banking scenario, fees and interest paid by the organization on a basis similar to those charged to everyone else by the bank could be misunderstood by the public. Additionally, reporting deposits and withdrawals could mislead the user to believe the bank is receiving income in excess of the actual fees.

Perhaps rather than reporting the volume of transactions, exempt organizations could be required to disclose that an interested person relationship exists and to describe the nature of the relationship. However, the AICPA does not support a requirement to disclose deposits and withdrawals in the ordinary course of business.

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

The IRS has requested 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. The AICPA does not believe that the component parts of a community trust should file separate Form 990-series returns.

The AICPA believes that, in the absence of a demonstrable reason for requiring component reporting, the long-standing approved aggregate reporting methodology embodied in Treas. Reg. § 1.170A-9(T)(f)(11) should be retained. Component reporting would impose a substantial burden on community trusts without any substantive benefit to the IRS or Form 990 user.

In a 1994 IRS continuing professional education (CPE) article,[3] the IRS set forth the history of community trusts as well as their organizational structure. It stated that "… the regulations governing trust-form community foundations create a legal fiction that allows individual trusts and funds to aggregate and become one. Without this structure, each trust and fund would be treated as a separate legal entity and would have to apply on its own for tax-exempt and public-charity status." In the absence of being treated as a single entity, the individual trusts or funds would be a group of related private foundations.

In the aforementioned article, community foundations were described as being particularly effective in serving the needs of their local communities for the following reasons: 1) Community foundations are knowledgeable – they focus only on their communities' needs, which helps them identify the neediest community institutions; 2) Community foundations are flexible – their specialized knowledge of the community helps them quickly change beneficiaries when local needs change; and 3) Community foundations are efficient – they provide economies of scale by aggregating modest gifts into endowments for similar purposes. Large endowments can tackle big community problems. In addition, the article noted their access to professional investment management.

In light of the foregoing advantages of community foundations, it would be disadvantageous if the adoption of component reporting led to their diminution or demise as a consequence of donors opting to establish their own private foundations. Given the advantages of community foundations cited by the IRS, and the fact that a substantial number of private foundations lack such attributes, the AICPA believes that the aggregate method of reporting should be retained.

**11. Scope of related organization reporting on Schedule R**

The IRS has requested comments on the pros and cons of permitting certain types of organizations to be excepted from reporting on Schedule R. Schedule R reporting is intended to provide the IRS and the public with a picture of the filing organization's structure and controlling relationships.

*Split Interest Trusts including Charitable Remainder Trusts*

The IRS has indicated its concern for protecting the identity of donors by allowing organizations to exclude the names and addresses of contributors listed on Schedule B from the public inspection copy of the Form 990. The AICPA believes that requiring disclosure of the name, address and EIN of certain trusts, including charitable remainder trusts, in Schedule R, Part IV would violate this privacy concept. Many such trusts contain the names of individuals or families who deserve the same level of protection and confidentiality as those making direct contributions reported in Schedule B. If this reporting is

[3] Chapter K, Community Foundations by George Johnson and David Jones.

retained, the organization should be able to exclude the information in Part IV, column (a) from the public disclosure copy of the return.

*Voluntary employee beneficiary associations (VEBAs) exempt from tax under IRC section 501(c)(9)*

Schedule R reporting is intended to provide the IRS and the public with a picture of the filing organization's structure and controlling relationships. For purposes of Form 990 and Schedule R reporting, a "related organization" includes a sponsoring organization of or a contributing employer to a VEBA that is exempt under IRC section 501(c)(9).

Sponsors of welfare benefit plans funded with VEBAs are required under the Employee Retirement Income Security Act of 1974 (ERISA) to file an annual Return/Report of Employee Benefit Plan (Form 5500). The Form 5500 discloses the contributions made to the plan by the sponsoring employer(s), as well as benefits paid by the plan. As a result, the financial reporting on Form 990 in many cases duplicates the reporting on Form 5500. Similar to the Form 990, the Form 5500 is open to public inspection and provides the government, plan participants, and the public with a report of the plan's financial condition.

Members of a VEBA's governing body (i.e., trustees) are subject to ERISA standards for fiduciary conduct. ERISA prohibits certain "party-in-interest" transactions (e.g., self-dealing) and requires that plan fiduciaries act in the interest of plan participants. However, many VEBA trustees are not officers of the sponsoring employer. The VEBA trustee may be a union member or other non-management employee.

The Form 990 reporting requirements for VEBAs are overly burdensome to the extent these requirements duplicate the sponsor's ERISA reporting obligations on Form 5500. In addition, Form 990 reporting can compromise the confidentiality of the individual VEBA trustees. For these reasons, the AICPA recommends that contributing employers and sponsoring organizations of a VEBA should be excluded from the definition of "related organization" for Form 990 reporting purposes.

*Religious organizations and churches in a religious denomination or association*

In the case of religious organizations, the AICPA suggests permitting some level of "reasonableness" when determining which organizations to report on Schedule R. While the Pope may have ultimate authority in a Catholic organization by the exact definition of control, we suspect that many organizations have drawn a figurative circle around the most relevant related organizations, and have only reported those, balancing the risk of an "incomplete return" with the logic and practicality of how the organization really functions. The AICPA suggests that additional exceptions from reporting requirements on Schedule R be considered for large religious organizations with many potential related organizations. Perhaps the IRS could permit such organizations to use Part VII (Supplemental Information) of Schedule R to describe the entities not included in the rest of Schedule R.

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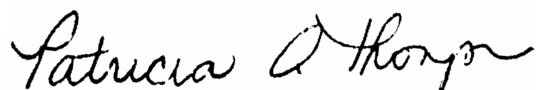
We look forward to working with you in the future on this matter. If you have any questions, please contact Debra C. Cook, Chair, AICPA Exempt Organizations Tax Technical Resource Panel, at (405) 552-3827 or dcook@kpmg.com; Jeffrey D. Frank, Vice Chair, AICPA Exempt Organizations Tax Technical Resource Panel, at (317) 656-6921, or jdfrank@deloitte.com; or Melissa M. Labant, AICPA Technical Manager, at (202) 434-9234, or mlabant@aicpa.org.

Sincerely,



Patricia Thompson, CPA
Chair, Tax Executive Committee