

## IRS Releases Draft Instructions for 2008 Form 990

On April 7, 2008, the IRS issued for public comment the much-anticipated [draft instructions](#) for the 2008 Form 990 (Return of Organization Exempt from Income Tax). The final version of the substantially revised Form 990, which must be completed by tax-exempt organizations for taxable years beginning in 2008, was [released](#) in December 2007. The instructions clarify the scope of certain questions and also provide definitions important to completing the new form. This alert highlights several points of particular interest.

If your organization has comments on the draft instructions, it should consider submitting the comments individually, as part of an industry group, or even anonymously through a third-party representative. The comment period for the draft instructions ends on June 1, 2008.

Compensation Reporting for Key Employees. IRS officials recently had hinted that an expanded definition of “key employee” would be contained in the draft instructions. The new key employee definition requires compensation disclosure not only for employees who have the same responsibilities as officers, but also for employees earning in excess of \$150,000 who manage a segment of the organization that represents five percent or more of the organization’s activities, assets, income or expenses, as well as for such employees who have or share authority to control or determine five percent or more of the organization’s capital expenditures, operating budget or employee compensation. This definition is likely to be controversial, and you may wish to consider its application to your organization.

Retention of Volunteer Exception to Compensation Disclosure. The draft instructions retain the current “volunteer exception” to compensation disclosure, so that no compensation reporting is required for amounts paid by a related for-profit organization to a filing organization’s directors, officers or trustees who receive no compensation from the filing organization.

Deferred Compensation Reporting. The draft instructions provide particular guidance on reporting deferred compensation for individuals whose compensation must be detailed on the new Schedule J (Compensation Information). The draft instructions indicate deferred compensation must be reported prior to vesting, stating that if an employee is required to perform services for a particular period before deferred compensation is paid, then the amount is treated as earned ratably over the course of the service period, even though unfunded and even if subject to substantial risk of forfeiture. The IRS has requested comments on whether reporting should not be required prior to vesting. In addition, the instructions state that earnings accrued on deferred amounts must be reported, as well as increases in actuarial value, but only to the extent the earnings exceed 120 percent of the Applicable Federal Rate (an IRS rate based on the return on Treasury bills).

Reporting of Fringe Benefits. New Schedule J includes check boxes that require an organization to indicate whether certain types of benefits, including first-class travel and club dues, are paid to officers, directors, trustees or key or highly compensated employees. The draft instructions clarify that first-class travel includes any upgrades that require the filing organization to incur additional costs, but that club dues do not include on-

premises athletic facilities. The draft instructions also state that when reporting nontaxable benefits on the Schedule J compensation table, there is no need to report the value of certain fringe benefits, including those excluded from income under section 132 of the Internal Revenue Code, which includes working condition fringe benefits (previously, the instructions stated that only de minimis fringe benefits did not need to be disclosed).

Definitions of “Hospital” and “Facility” for Schedule H Reporting. As IRS officials had suggested in informal comments, organizations required to complete the new Schedule H (Hospitals) are those organizations that operate (including through disregarded entities and joint venture partnerships) at least one facility that is required to be or is licensed or certified as a hospital under state licensing or certification laws. The instructions clarify that a single Schedule H should be completed by an organization that operates multiple hospitals. Identifying information about separate facilities must also be reported on Schedule H. For this purpose, a “facility” includes a campus, building, structure or other physical location where medical or hospital care is provided by the filing organization, such as medical outpatient facilities, surgery centers, urgent care clinics and rehabilitation facilities (including those operated through disregarded entities or joint venture partnerships).

Organization Governance and Structure. The instructions provide definitional guidance with respect to the Form 990’s new focus on organizational governance and structure. For example, the new form asks how many members of the filing organization’s governing body are “independent.” The draft instructions state that a member is not independent if the member received compensation as an officer or other employee of the organization or related organization, or received (directly or indirectly, including through family members) “material financial benefits” from the filing organization or a related organization. The draft instructions state that “a transaction with an amount greater than \$50,000 is a per se material financial benefit for this purpose.” A member is not considered to lack independence because he or she has received reasonable expense reimbursements, compensation for service as a member of the governing body, or up to \$10,000 in compensation as an independent contractor.

“Investment Partnership” Exception for Reporting Transactions with Unrelated Partnerships. The draft instructions to Schedule R provide an exception from the general requirements for reporting certain transactions with unrelated partnerships if 95 percent or more of the filing organization’s gross income from the partnership comes from income such as interest, dividends, royalties, rents and capital gains, and where the primary purpose of the investment is to produce income or the appreciation of property. This exception is apparently intended to address investments in investment partnerships, but would exclude partnerships with significant income from operating pass-through entities such as LLCs.

Transactions with Interested Persons. The draft instructions provide clarification regarding reporting business and financial transactions with interested persons (such as officers, directors, trustees, key employees, etc.) in Schedule L. The instructions provide a “large board” exception for an organization with more than 20 voting directors or trustees in its governing body and an executive committee for ongoing governance decisions; this exception allows the organization to disregard certain transactions with current or former directors or trustees that are not current members of the executive committee, or officers, key employees, or the highest-compensated employees of the organization. The draft instructions also establish a \$10,000-per-transaction threshold for reporting business transactions involving interested persons.

Reporting Significant Dispositions of Assets. Schedule N requires organizations to report significant dispositions of assets, which include a sale or exchange of more than 25 percent of an organization’s net assets or a substantial contraction of net assets. The instructions clarify that this reporting requirement will not apply to an organization’s change of the composition of its passive investment portfolio.

Statement of Program Service Accomplishments. The IRS has requested comments on specific examples of accomplishments to be reported by organizations in specific sub-sectors (for example, all nursing homes, hospitals, colleges and universities).

No Advance Rulings of Publicly Supported Status. The draft instructions provide that the IRS expects to cease issuing advance rulings regarding publicly supported charity status, but will issue an exemption letter if the IRS determines that the applicant organization can reasonably be expected to be publicly supported. The applicant organization will no longer file a Form 8734 at the end of the four-year advance ruling period, but will (beginning with its sixth tax year) be required to establish by filing the Form 990 that it is not a private foundation (using a five-year computation period).

Glossary of Key Terms. The instructions now contain a glossary of definitions of 176 terms referred to in the form so that organizations need not examine the instructions for each of the form's 16 schedules to locate one definition.

### Contact Information

If you have questions about the new Form 990 or related issues, please contact your usual Ropes & Gray attorney or:

**Peter C. Erichsen**  
**Elizabeth M. Norman**

**Carolyn M. Osteen**  
**Kendi E. Ozmon**

**A.L. (Lorry) Spitzer**

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