



May 30, 2008

Internal Revenue Service
Form 990 Redesign, SE:T:EO
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: COMMENTS: DRAFT INSTRUCTIONS ON REDESIGNED FORM 990

On behalf of the Health Care Law Section of the State Bar of Michigan, thank you for the opportunity to comment on the draft Instructions to the redesigned Form 990. We appreciate the work that the IRS has put into the new form and Instructions and its openness to comments from the healthcare community.

Our Task Force, the members of which are listed on Exhibit A of this letter, respectfully submits the following comments for your consideration.

General Comments

As a general matter, we suggest including in the Instructions more information about the effect of a “no” answer. In addition to tax-exempt organizations, members of the public and the press will be reviewing the Form 990 filings and will be interpreting and attempting to understand the information that is disclosed based in some part on the Instructions. We applaud the IRS’ hard work and significant effort to prepare the form and the Instructions for completion by several different types of tax-exempt organizations, and suggest that the Instructions are the opportunity for education and clarification about the disclosures and the IRS’ use of the form.

1. Definition of “independent” in connection with directors of tax-exempt organizations.

In the core form and Schedule H the Instructions raise an issue regarding the composition of the governing board of a tax-exempt organization. The implication is that a significant number of “independent” directors should be on

the board. We suggest that the IRS adopt an existing definition of “independent.” The definition of independent in the Instructions is new, and also is much narrower than the definitions (1) in the Internal Revenue Code for disqualified persons and (2) used by the IRS for purposes of the rebuttable presumption in TBOR2 (Section 4958 regulations). We suggest that the IRS adopt one of these two existing definitions for “independent.” Alternatively, we suggest that the Instructions be revised to increase the payment amount that causes an employee or officer to be excluded from the definition of “independent.” Further, we suggest that an appropriate amount of payment would be the limit set for highly compensated employees under IRC Section 414(q).

Board composition is raised again in the Instructions regarding community service. The implications from the board composition example in the Instructions for demonstrating community service could be misleading, causing tax-exempt organizations, the public and regulators to misinterpret the IRS definition. The Instructions seem to set a standard of independence that is not consistent with current state laws on conflicts of interest or prior IRS rulings or guidance. We suggest that the Instructions clarify that the IRS’ collection of data about independent and local community board members is not a reflection of non-compliance for reporting tax-exempt organizations with non-private foundation and public charity status.

Further, we request that the IRS change the wording regarding the information being collected about board members’ residence in the applicable local area. We note that many reporting organizations recruit and include individuals with national expertise on their boards. We also believe that the IRS would benefit from gathering more information about the clinical expertise of board members. Further, with respect to community service we note that the Instructions do not list patient care and health care activities as illustrative of community service, despite the significance given to such activities in revenue rulings and IRS guidance.

2. Appropriateness of Schedules to Form 990.

New information not previously reported publicly is requested in several Schedules to Form 990. Due to the newness of the Schedules it is not likely that the Instructions will be interpreted in the same way by all reporting organizations. Further, it is likely the public and press will review and rely on information disclosed in such Schedules. We again suggest using the Instructions for education and that the Instructions explain that much of the information contained in the Schedules is intended to be used by the IRS for its internal informational purposes. We request that the Service note in the Instructions that “yes” and “no” answers are not a score and do not reflect either the value of tax exemption or the benefits to the public and community of the activities of the reporting organization. We believe that the IRS should caution readers that until the reporting tax-exempt organizations are able to establish industry practices and standardized data collection methods to compile and report the requested

information, comparisons based on the disclosed information are not helpful to the public, and could in fact, be misleading.

3. **Schedule H.**

As an initial matter we note that in some states (other than Michigan) hospitals may be registered or certified. Further, non-acute care facilities are licensed as hospitals in some states. We suggest that the definition of hospital be more limited for data integrity purposes. In addition to mere state licensure categories, we suggest defining a hospital as a facility license, registered or certified as a hospital under applicable state law that would be eligible to bill government payment programs for inpatient services. In addition, to the extent such hospitals conduct community benefit activities through other related entities that they fund or control, the Instructions should be revised to specify that those activities are includable at the hospital's option in Schedule H, Part II, Line 9 (Community Building Activities – Other).

Based on comments made by IRS representatives in a call with the American Health Lawyers Association, we understand that the facilities to be listed in Part V are to be included because the community benefit activities of these facilities are to be reported in connection with the hospital(s) operated by the reporting tax exempt organization. However, the aggregation Instructions and the interchangeable use of the terms "hospital" and "facility" are confusing. It appears, for example, that question 3 should refer to the hospital(s), not a facility. In addition, more instruction is needed on aggregation for "yes" and "no" answers. What if the answer is "yes" for one hospital, but "no" for another? If a majority is to be used, is it based on the number of licensed beds or some other basis (i.e., number of employees, allocation of patient revenue)? We suggest that the IRS clarify what is intended so that hospitals can properly respond to this Question.

We believe that aggregate reporting of community benefit expenditures at the reporting tax-exempt organization level for all of its hospital facilities is helpful in providing information regarding at least a part of the community benefit the organization provides. Aggregate information also is consistent with the application process used to determine tax-exempt status for most, if not all, organizations. After review, study and analysis, however, it appears to us that an aggregate Schedule H will be difficult to complete and may not be of significant value to the IRS for data collection purposes because the charity care policies may vary from one licensed facility to the next, making "yes" or "no" answers potentially misleading on several questions in Schedule H. One option would be to require one Schedule H for all related licensed facilities under common control with appropriate explanation from the reporting entity (on Schedule O) of the extent to which answers to various "yes" or "no" questions are not uniformly applicable to all of its hospital facilities. We also suggest, as an alternative, that the IRS permit the tax exempt organization to prepare one Schedule H per licensed hospital if it desires to do so for the "yes" and "no" answers, and

complete the numerical section on an aggregate basis for the tax exempt organization on a single combined Schedule H for all of its hospital facilities.

We suggest that the Instructions on the cost accounting method clarify that the reporting organization may use any reasonable method that currently is in use by the reporting organization for any other purpose. We believe that the organization should disclose the method used and for what other purpose it is in use, rather than attempt to choose a method it deems most accurate. We further suggest that the Instructions specifically state that there is no standard method to avoid confusion to readers. Due to the non-comparability of data we suggest that the IRS further acknowledge that the data is being collected for the IRS' education about methods currently in use.

The draft Instructions for Schedule H, Worksheet 4 (page 19 of 23), would limit (potentially significantly) the amount of community benefit activities that a hospital is permitted to report on Schedule H. Specifically, the draft Instructions provide that:

Activities or programs may not be reported if they are provided primarily for marketing purposes and the program is more beneficial to the organization than to the community; for instance, if the activity or program is designed primarily to increase referrals of patients with third-party coverage, **required for licensure or accreditation,** or restricted to individuals affiliated with the organization.

(Emphasis added.)

We request that the IRS clarify this Instruction regarding data requested about charitable activities. For example, in Michigan (and possibly other states) accepting Medicaid patients and payments for services from the Medicaid program is effectively required by state law for health planning purposes. See Mich. Comp. Laws § 333.22230. We suggest that state law requirements do not "invalidate" operation in a charitable manner entitling the reporting organization to recognition of tax-exempt status or make its activities any less of a benefit to the community. For example, if the organization accepts Medicaid for all services and not for only a limited number of services, this reflects operation in a manner beneficial to the community, in contrast to operation in a manner that primarily benefits the organization. We suggest that the IRS address state law and other variations by allowing the voluntary reporting of more information about the nature and extent of the tax-exempt organizations' charitable activities.

4. **Schedule J.**

We suggest that the Instructions for question 5 about contingent payments merely state that revenues include both gross and net revenues as reflected by the term "revenues" in the form itself. Further, we suggest that the examples are more in the nature of Instructions than illustrative. We suggest that the IRS clearly state that for reporting purposes the term "contingent" means an amount determined based on a percentage of revenue or income, perhaps based on any "revenues" reported on core form Part VIII.

We note that the form does not take into account benefits provided via a cafeteria plan. A cafeteria plan is one that allows an employee to choose which type of fringe benefits the employee needs. One employee may choose an entirely different set of fringe benefits than another employee chooses. We suggest that it would be deceptive to include these benefits in disclosures in the schedule because the information requested is not just W-2 reported income, but also pre-tax and other employee fringe benefits not reportable as income. We suggest that the IRS clarify the Instructions related to W-2 box 1 income. We note that IRS excess benefit guidance provides that if the benefit is not reported on Form 990 it could be an excess benefit, even though the benefit is not required to be reported on the W-2, is excluded from income, and not required to be reported on any other form.

5. **Schedule L.**

We support the large board exception in Schedule L for reporting of business transactions (Schedule L, Part IV) and urge the IRS to retain this exception. We believe it is a useful and appropriate exception in several respects, including (a) minimizing the recordkeeping burden (one of the stated goals of the revision) for organizations with larger governing boards (e.g., community-based foundations, alumni groups and even community hospitals where donors frequently end up on the board or board size grows with a series of mergers), and (b) focusing on information that is more relevant for tax compliance purposes – the potential for abuse in business transactions with the most active board members, those in a position to control or substantially influence what action is taken on behalf of an organization (which typically would be limited to the members of the executive committee in an organization with a large board).

6. **Question 10, Part VI, Schedule O.**

We recognize that the IRS' view is that good governance practices are reflective of the likelihood of compliance with federal tax laws. That concern is reflected in a variety of governance-related questions in the final Form 990, particularly in Part VI of the Core Form. Although we are using the question about board review of the Form 990 (Core Form, Part VI, Line 10) to illustrate our point, we believe similar concerns apply to how the public may interpret answers to all of the governance questions.

Initially we note that the Instructions should require all reporting organizations to file Schedule O as the Core Form, Part VI, Line 10 requires Schedule O to be completed to address the Form 990's board approval process whether they answer the question "yes" or "no". With respect to the draft Instructions for Core Form, Part VI, Line 10, however, we believe additional explanation of the significance (or lack thereof) of a "no" answer is appropriate because there are a variety of approaches to preparation and review of Form 990 which may indicate good governance. A "no" answer to that question (or others) does not necessarily suggest a deficiency in governance practices, rather each organization's practices should be evaluated based on the relevant facts, circumstances and applicable state laws, including alternative procedures in effect at the organization.

In that regard, both state law and good governance practices allow conduct of organization activities at a meeting at which a quorum is present (even if some directors are absent and have not read or received meeting materials) and delegation to committees, experts and officers. Many boards currently do delegate significant activities to committees or advisors with special expertise for a higher level of quality of the review. In fact, many reporting organizations currently rely on review of tax questions or returns by the audit or finance committee. In fact, the regulations under Section 4958 already recognize the appropriate governance practice of obtaining and relying on expert advice (internal or external) in dealing with federal tax questions. See Treas. Reg. §§ 53.4958-1(d)(4)(iii) & -6(c)(2)(i). Conduct of activities in this manner often is a better governance practice than review by the full board. The requirement of a "no" answer for Core Form, Part VI, Line 10 if the pre-filed Form 990 is not given to each Board member in advance may not take into account other methods for the conduct of governance business by organizations, as permitted by good governance and applicable law. We suggest that the Instructions recognize that governing body review may be completed by a committee, an officer with expertise who is delegated the review and certification authority or by an external firm hired to conduct the review based on its expertise and experience.

Given the alternative ways in which good governance can be achieved, we request that the Instructions include clarification that a "no" answer to question 10, Part VI on the Core Form about board review or to other questions in Part VI of the Core Form is not a reflection of inadequate review. We also request that the IRS recognize in the Instructions for Line 10 that board review or an appropriate equivalent process can be accomplished through the methods outlined above. Finally, we request that, due to the public disclosure of the form, the IRS clarify that no current board review is required by the Code (nor are the various other characteristics, policies and practices in Part VI generally required by the Code) and a "no" answer is not reflective of the quality of the organization's governance.

* * * * *

On behalf of our Task Force, we thank you for the opportunity to comment on the Instructions to the redesigned Form 990. Should you wish to communicate with our Task Force, please contact either of the Co-Chairs of the Task Force, where noted below.

Sincerely,

Ann T. Hollenbeck
Co-Chair, Form 990 Task Force
ahollenbeck@honigman.com

Cynthia F. Wisner
Co-Chair, Form 990 Task Force
wisnerc@trinity-health.org

REDESIGNED FORM 990 TASK FORCE MEMBERS

CO-CHAIRS

Ann T. Hollenbeck
ahollenbeck@honigman.com

Cynthia F. Wisner
wisnerc@trinity-health.org

Participants

Kathy Kudner
kkudner@dykema.com

Billee Lightvoet Ward
ward@millercanfield.com

Christian Schafer
SCHAFECL@trinity-health.org

Ryan J. Powers
ryan.powers@spectrum-health.org

Mark R. Lezotte
mark.lezotte@oakwood.org

Robert Alpiner
Robert.Alpiner@hantzgroup.com

Gerald Griffith
ggriffith@JonesDay.com

copy to:

Lisa Panah
lisa.panah@kitch.com