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Form 990 Draft Instructions Need Refinement to Present An Accurate Picture of Tax-Exempt Health Care Organizations

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The IRS released detailed draft instructions to accompany the final Form 990 on April 7, 2008 ("Draft Instructions"). Together, the Form 990 and the Draft Instructions increase transparency and promote accountability among tax-exempt organizations by gathering more data about the activities of these organizations. The reporting guidance provided in the Draft Instructions will play a key role in determining how the outside world sees tax-exempt organizations, particularly tax-exempt health care providers. It is important that what the outside world sees is a realistic picture of what actually occurs within tax-exempt organizations and not a distorted image of the good work that these organizations perform.

Public comments submitted to the IRS prior to the June 2, 2008, deadline indicate that some aspects of the Draft Instructions raise general concerns about the scope of information that must be disclosed in response to Form 990 and create anxiety regarding how the IRS and others might use such information. In finalizing the Form 990 itself, the IRS demonstrated careful consideration of the nearly 700 public comment letters that it received.[1] This experience, coupled with public comments from IRS representatives, indicates that tax-exempt organizations should expect the IRS to consider carefully their concerns about the Draft Instructions.

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In general, the new Form 990 and the Draft Instructions elicit two types of information. Information tied to tax compliance which the IRS needs to perform its enforcement mission and other information, not tied directly to tax compliance, which is there to serve a "transparency" goal and which is justified, in the IRS's view, by the notion that "a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance."[2] While that may be true, in several respects, the Draft Instructions seem to strike an inappropriate balance between the IRS's need for information to enforce federal tax laws and the administrative burden imposed on filing organizations to disclose that information.

In other respects, the Draft Instructions seek information that does not reflect any substantive, tax law requirement, but which seem to suggest an IRS bias in favor of certain policies and behaviors that the IRS apparently thinks are "best practices," even though these practices are not required by the Internal Revenue Code. Thus, there is a disconnect between what is required for tax law compliance and these "best practices," and this disconnect carries with it the very real

[1] "IRS Releases Final 2008 Form 990 for Tax-Exempt Organizations, Adjusts Filing Threshold to Provide Transition Relief," IRS Release 2007-204 (Dec. 20, 2007).

[2] IRS, "Governance and Related Topics – 501(c)(3) Organizations," available at http://www.irs.gov/pub/irs-tege/governance_practices.pdf.

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danger that the general public, members of the media, and non-tax regulators, such as attorneys general, will be critical of tax-exempt organizations that do not comply with these implied ''best practices.'' In that regard, the Advisory Committee on Tax Exempt and Government Entities (''ACT'') has urged the IRS to proceed cautiously with governance questions that imply ''best practices'' and to explain the relationship of each governance question to a specific tax compliance concern.[3]

At a minimum, the IRS needs to be clear about which provisions of the Form 990 and Draft Instructions are needed for tax-law compliance and which provisions go beyond tax law compliance. The Draft Instructions should contain an express statement, much like the statement in the ''rebuttable presumption'' Regulations, that failure to have certain policies or procedures, or to engage in certain behaviors, does not mean that the organization is noncompliant. Additionally, the Draft Instructions for Schedule H require organizations that operate hospitals to disclose a variety of information relating to their activities. The Draft Instructions require disclosures such as how the organization identifies and computes ''community benefit,'' how the organization determines whether a patient is eligible for charity care, how the organization distinguishes between bad debt and charity care, how the organization educates patients about charity care and collection matters, how the organization assesses the needs of patients about charity care and collection matters and how the organization identifies the needs of the communities it serves. While the IRS acknowledges that Schedule H and the Draft Instructions do not purport to establish or to change substantive law, it is a fair inference that, in all likelihood, the Draft Instructions for Schedule H describe the IRS's view of the factors it uses to determine whether such an organization satisfies the community benefit standard, and thus may reflect a virtual checklist for future community benefit audits.

In addition, Schedule H seems not only to be collecting information that is helpful in enforcement, but also information that may be used to modify the substantive standards for tax exemption of health care organizations, perhaps to a significant extent. In three to five years, the IRS will have collected a substantial database of information about the health care sector. This database may be used by legislative bodies to change the laws governing exemption. It is also possible that the IRS, without waiting for Congress to act, will use the information gathered to make administrative changes (by regulation or Revenue Ruling). After all, Revenue Ruling 69-545, which sets forth the current community benefit standard, is a revenue ruling—an administrative pronouncement—and when it was issued, it changed the standard for tax exemption from the old, more restructure ''charity care'' standard set forth in Revenue Ruling 56-185. The IRS did it once without Congressional mandate and could do so again.

As a result, the stakes for tax-exempt health care organizations in completing Schedule H are very high. The information provided in response to the Form 990 will enable the IRS to engage in more focused and more effective audit and enforcement activities. Additionally, because the Form 990 is a publicly available document, the disclosures required by the Form and its Instructions will be the principal way an organization presents itself not only to the IRS but also to federal, state and local legislative bodies, to state regulators, including state attorneys general and state tax authorities, to the various media and to the general public, including various special interest groups which may not have the organization's best interest at heart.

Given the scope of revised Form 990 and the likely impact that it will have on the organizations that complete it, it would be appropriate for the IRS to refine the Draft Instructions to ensure that they solicit information that accurately describes their activities and assists the IRS in enforcing federal tax laws. Specific areas for improvement in that regard would include reconsidering the Draft Instructions for board member independence, excess benefit transaction reporting requirements, and business transaction reporting requirements; retaining the large board exception; and providing additional guidance on joint venture reporting requirements.

Board Member Independence. The Draft Instructions for Part VI, Section A, Line 1b state that a member of a governing body will be ''independent'' only if each of the following four criteria are satisfied at all times during the filing organization's tax year:

1. The individual was not compensated as an officer or other employee of the organization or of a related organization, except for those individuals who serve as an agent of a religious order or a religious or apostolic organization and who have taken a bona fide vow of poverty under circumstances in which such individual would not have received taxable income.
2. The individual did not receive total compensation or other payments exceeding $10,000 for the year from the organization or from related organizations as an independent contractor, other than reimbursement of expenses or reasonable compensation for services provided in the capacity as a member of the governing body.
3. The individual did not otherwise receive, directly or indirectly, ''material financial benefits'' from the organization or from a related organization.
4. The member did not have a family member that received compensation or other material financial benefits from the organization or from a related organization.[4]

The Draft Instructions do not specifically define a ''material financial benefit.'' The Draft Instructions do state, however, that any transaction that would be reportable in Schedule L (e.g., those individual transactions exceeding $10,000) would constitute a ''material financial benefit.'' The Draft Instructions also establish a *per se* rule that any ''transaction with an amount greater than $50,000'' is a material financial benefit.[5]

This new definition of ''independence'' is potentially troubling for a variety of reasons. For example, it is far broader than the scope of who may be a disinterested director for purposes of establishing the rebuttable presumption of reasonableness under Internal Revenue Code (''IRC'') § 4958. Additionally, the broader scope of

[3] ''The Appropriate Role of the Internal Revenue Service With Respect to Tax-Exempt Organization Governance Issues,'' p. 50 (ACT, June 11, 2008), available online at http://www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf.

[4] Draft Instructions, Form 990 (2008), Core Form, Part VI, at p. 1-2.

[5] Draft Instructions, Form 990 (2008), Core Form, Part VI, p. 1 of 9 and Glossary, p. 12 of 24.

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individuals who will have some interest in the organization may lead to a more unfavorable perception of the quality of governance than is warranted. Moreover, it may be difficult—if not impossible—for an organization to find prospective board members with the requisite skill set to attain a majority of ''independent'' board members under this definition.

In part, the Draft Instructions also confuse conflicts of interest with independence, but these are separate concepts and should be treated that way. A conflict of interest is a transactional concept that is determined on a case-by-case basis (looking at who stands to gain directly or indirectly from a transaction), while independence is not a transactional concept but an overall look at an individual's relationship to the organization. Conflicts of interest are adequately defined in the excess benefit transaction regulations related to the rebuttable presumption procedure.[6] The Draft Instructions appropriately incorporate that definition of conflicts of interest with respect to the compensation process,[7] though that definition has not yet been included in the Glossary for broader use throughout the 2008 Form 990.

Independence, on the other hand, looks at whether the individual's ties to the organization overall make it more or less likely that the individual will put aside personal and financial interests and make decisions that advance the mission and activities of the organization as opposed personal goals and interests, especially personal financial goals and interests. The approach referenced below from the FY 1997 CPE Text of a ''close and continuing'' financial relationship test for independence remains essentially correct. That is, employees are not independent because they depend on the organization for material economic benefits—a point captured in the first factor of the Draft Instructions' proposed definition of independence.

Non-employees may be independent, however, even with some financial relationship, as long as it is not a material, close and continuing relationship. For non-employees, this necessarily requires a case-by-case examination of the individual's financial ties with the organization. In that regard, the remaining factors that the IRS proposes to use for determining independence are potentially overly broad. Additionally, the use of such rigid factors may make it difficult for many organizations, particularly in smaller communities, to recruit and retain board members with an appropriate range of experience who also meet the rigid criteria of independence outlined in the Draft Instructions.

The conflict definition of Treasury Regulation § 53.4958-6 is focused on excess benefit transactions, which are economic benefits only, and so the regulations focus solely on economic relationships. Private inurement is also an economic concept. It seems that these are the two primary concerns for having independent board review—avoiding excess benefits and avoiding inurement. Accordingly, the Draft Instructions should limit both conflicts of interest and independence to economic factors and should apply these principles to all exempt organizations, not just those described in IRC §§ 501(c)(3) and 501(c)(4). To a large extent, the factors for independence that the IRS proposes in the Draft Instructions do just that. However, a number of the factors are overly broad and may pick up isolated, infrequent or, in smaller communities, practically unavoidable transactions.

One non-financial interest that arises frequently for boards of directors, which is covered in Treasury Regulation § 53.4958-6, is a family relationship. Clearly, any family relationship within the IRC § 4958(f)(4) definition of family should apply for conflict of interest purposes but not necessarily for independence purposes. Again, the family tie is directly relevant to the conflict of interest inquiry, but it may or may not rise to the level of something that will give the board member a close and continuing financial relationship to the organization which undermines the board member's ability to be classified as independent. In other words, the family relationship may be a relevant consideration but should not necessarily be determinative as it could be under the Draft Instructions. A facts-and-circumstances inquiry would be more appropriate. On one end of the spectrum would be a family member who is a son or daughter who is a key employee or whose other family members control the board, as in the *Caracci/Sta-Home* case.[8] On the other end would be the family member who is in a non-key employee position for an organization that has a majority independent board.

For all of the above reasons, the IRS would be better served in the Draft Instructions if it adhered to the approach for independence articulated in the FY 1997 Continuing Professional Education Text article, ''Tax-Exempt Health Care Organizations Community Board and Conflicts of Interest Policy'' (the ''1997 CPE Text'').[9] In the 1997 CPE Text, the IRS noted that practicing physicians affiliated with the hospital, officers, department heads and other employees of the hospital are not independent ''due to their close and continuing connection with the hospital.''[10] On the other hand, other persons, who may have some business dealings with the hospital, but who do not, as a result, have a ''close and continuing connection with the hospital'' are usually considered to be independent.[11]

The IRS recently used a similar facts and circumstances analysis in the Treasury Regulations released on March 28, 2008.[12] The March 28 Regulations describe the standards that the IRS will use to determine whether or not to revoke the IRC § 501(c)(3) status of an organization that has engaged in a transaction that constitutes both (i) traditional private inurement under IRC § 501(c)(3) and (ii) an excess benefit transaction under the intermediate sanctions rules of IRC § 4958. Those Regulations set forth a series of five factors and then follow those factors with a series of examples indicating how the factors should be applied in different facts and circumstances. Under those Regulations, a direct connection exists between responsible corporate governance and compliance practices and continued tax exemption, making them an appropriate source for the independence standard for Form 990.

Excess Benefit Transactions. Part IV, Lines 25a and 25b require each organization to disclose whether it has participated in any excess benefit transaction. The

[6] See, e.g., Treas. Reg. § 53.4958-6.

[7] Draft Instructions, Core Form, Part VI, page 7 of 9.

[8] See, e.g., *Caracci v. Comm'r*, 456 F.3d 444 (5th Cir. 2006).

[9] Lawrence M. Brauer and Charles F. Kaiser, 1997 CPE Text, ''Tax-Exempt Health Care Organizations Community Board and Conflicts of Interest Policy.''

[10] 1997 CPE Text pp. 18-19.

[11] *Id.*

[12] 73 Fed. Reg. 16,519 (March 28, 2008).

Draft Instructions caution exempt organizations that engaging in an excess benefit transaction may have "serious implications" for the disqualified person involved, the organization managers who approved the transaction and the organization itself. This last warning serves as a reminder of the standards that the IRS articulated in the March 28 regulations describing the relationship between excess benefit transactions and private inurement. The Draft Instructions recommend that organizations who become aware of an excess benefit transaction should "obtain competent advice regarding section 4958, consider pursuing correction of any excess benefit and take other appropriate steps to protect its interests with regard to such transaction."[13] The final regulations indicate that these recommended actions are necessary for an organization to retain its exempt status when it has participated in an excess benefit transaction that also constitutes private inurement.[14]

Organizations that report an excess benefit transaction in Part IV, Lines 25a and 25b must complete Schedule L, Part I. The Draft Instructions to Schedule L, Part I, however, do not define the scope or amount of information that an organization would need to disclose with respect to the excess benefit transaction. For example, the Draft Instructions for Schedule L, Part I, Line 1 call for the organization to "identify" the affected disqualified person(s) and organization manager(s), describe the transaction and state whether or not it has been corrected (e.g., by repayment with interest). Yet they do not address whether an organization that suspects an excess benefit transaction and wants to disclose but fears a defamation claim (e.g., due to differences of opinion over disqualified person status or fair market value) may elect to disclose by listing the position or general description of the business of the recipient without naming names. If the excess benefit transaction in question is a "material diversion of assets," the Draft Instructions (Core Form, Part VI, Line 5) suggest some sensitivity to identifying the parties involved in an excess benefit transaction by stating that "the person or persons who diverted the assets should not be identified by name."[15] The Draft Instructions for Schedule L do not include a similar provision for excess benefit transactions generally. Perhaps the difference relates to concerns with interfering with a criminal investigation, though that distinction does not necessarily relate only to material diversions of assets, plus the consequences of a defamation lawsuit could be similarly severe for a filing organization.

Implicitly, the Draft Instructions require the organization to define what constitutes a "transaction." In certain circumstances, such as an isolated contract to buy property from a disqualified person at well above fair market value, this might be easy to do. But, for automatic excess benefits (e.g., failure to capture expense reimbursements through an accountable plan, Form W-2 or Form 1099), this could be cumbersome. For example, would each meal that is unsubstantiated be a separate transaction for reporting purposes or do the aggregate unsubstantiated meals constitute a "transaction"? The Draft Instructions suggest the most conservative approach—each meal is a separate transaction. However, this obviously increases the burden on the filing organization, with little added benefit for the IRS or the public. The limitations of electronic filing software also may not permit a separate listing of each meal. A more reasonable approach would be the one the IRS used in Part IV of Schedule L, allowing a filing organization to refrain from reporting smaller amounts ($10,000 or less) and aggregating larger amounts (more than $10,000) and report the aggregate amount by type of transaction.[16]

Schedule L, Part I, Line 2 also requests that the organization "enter the amount of tax imposed on the organization managers or disqualified persons during the year under section 4958."[17] The Draft Instructions take this disclosure one step further by requiring the organization to "enter the amount of taxes imposed on organization managers and/or disqualified persons under section 4958, ***whether or not assessed***, unless abated."[18] This suggests that the IRS expects the organization to calculate the excise taxes arising from an excess benefit transaction. Yet, the Draft Instructions provide no guidance to the organization about how it should make this calculation. Presumably the filing organization should report the first-tier tax of 25 percent only if no assessment has been made, since the disqualified person would have the opportunity to pay the first-tier tax before the second-tier tax of 200 percent is applied. If, however, the excess benefit appears to be flagrant or repetitive, it is less clear whether the 100 percent penalty should be applied to double the excise tax reported.[19]

Reporting of Business Transactions. Schedule L, Part IV requires an organization to report certain information regarding business transactions with interested persons. The Draft Instructions do not establish an exception to these reporting requirements for *de minimis* levels of ownership by directors or trustees in partnerships or professional corporations. In that regard, the required disclosure arguably goes beyond the bounds of what is reasonably required to monitor and enforce the private inurement, private benefit and excess benefit rules. A more appropriate approach in the final Instructions would be to create exceptions to this disclosure requirement for (a) ownership interests in a partnership or professional corporation where such an organization is not involved in providing health care or managing the delivery of health care services or is publicly marketed to the general public or accredited investors as an investment, and (b) clearly *de minimis* interests in a professional corporation, e.g., 10 percent or less of vote or value. Doing so would be consistent with how the Draft Instructions treat joint ventures for purposes of the business transaction reporting requirements. For example, the Draft Instructions state that, "business transactions" include "joint ventures, whether new or ongoing, in which the profits or capital interest of the

[13] Draft Instructions, Form 990 (2008), Core Form, Part IV, p. 4 of 6.

[14] 26 C.F.R. § 1.501(c)(3)-1(f)(2)(ii).

[15] Draft Instructions, Form 990 (2008), Core Form, Part VI, p. 4 of 9.

[16] Draft Instructions, Form 990 (2008), Schedule L, p. 6 of 7.

[17] Draft Instructions, Form 990 (2008), Schedule L, p. 3 of 7.

[18] *Id* (emphasis added).

[19] See 26 U.S.C. § 6684.

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organization and the interested person each exceeds 10%.''[20]

Large Board Exception. The Draft Instructions create a ''large board'' exception to Schedule L, Part IV business transaction reporting requirements for any organization having more than twenty voting directors or trustees on its governing body and an executive committee that possesses delegated powers to act on behalf of the governing body. Such organizations may disregard the reporting requirements imposed by Schedule L, Part IV for all current and former directors or trustees that are not current members of the executive committee or officers, key employees or highest compensated employees of the organization. This exception is a rational, reasonable accommodation to minimize the reporting burden on filing organizations without materially affecting relevant transparency.

As drafted, the large board exception serves to (a) minimize the recordkeeping burden 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), (b) minimize the negative effects on recruitment of a diverse, community board by minimizing the extent to which directors' or trustees' financial affairs are publicly disclosed where there is no significant risk of abuse, and (c) focus on information that is more relevant for tax compliance purposes. In that latter regard, it would seem that the potential for abuse in business transactions relates primarily to transactions with the most active board members, i.e., those in a position to control or substantially influence what action is taken on behalf of an organization. This influential group typically would be limited to the members of the executive committee in an organization with a large board, and not the rank and file community trustees.

Joint Venture Reporting. The list of potentially relevant portions of the Form 990 for joint ventures in Appendix F should be a useful tool for filing organizations.[21] Given the variety of disclosures that may be required for Joint Ventures on the Form 990, the exempt organization community, particularly the health care sector, must be able to understand easily how the different joint venture reporting requirements in various Schedules as well as the Core Form interrelate and how they apply to specific transactions. The following table summarizes those requirements as they exist under the Form 990 and the Draft Instructions (the numbers in brackets are for convenience of reference only). The chart does not include references to general reporting of unrelated business income, conservation easements, foreign activities or fundraising and gaming, or certain grants affecting joint ventures, all of which are discussed in Appendix F with cross references to the relevant portions of the Draft Instructions.[22]

[20] Draft Instructions, Form 990 (2008), Schedule L, p. 6 of 7.

[21] In that regard, we did not include references to general reporting of unrelated business income, conservation easements, foreign activities or fundraising and gaming, or certain grants affecting joint ventures.

[22] We included references to Form 990-EZ where appropriate, but the Draft Instructions themselves, in the passages relevant to joint ventures, appear to reference only the Core Form 990 and not Form 990-EZ.

Joint Venture Reporting Obligations

Exempt Organizations participating in joint activities with otherwise unrelated organizations or with current or former (within the prior five years) officers, directors, trustees, key employees listed in Part VII, Section A of the Core Form 990 (''ODTKE'') or other staff may be required to disclose information regarding joint activities generally and specific transactions. This table is intended as a guide to the more common disclosure obligations for joint activities. For convenience, this table refers to all such joint activities as ''joint ventures'' regardless of the form or structure, including joint management arrangements. Reporting obligations identified below apply to all exempt organizations filing Form 990 except that Schedule H only applies to Hospitals as defined in the Instructions. These reporting obligations relate to the joint ventures in which the filing organization, or another organization covered by a group return, participate directly and do not apply to joint ventures by separate entities that are not required to file their own Forms 990 or be included in a group return. This table is for illustration purposes only and does not supersede the Instructions themselves. All of the Parts and Schedules listed below have additional disclosure requirements that apply outside of the joint venture context that are not summarized in this table. See Appendix F to Form 990 (2008).

Part/Schedule:	**Applies To:**	**Exceptions/Notes:**
[1] Core Form, Part IV, Line 26; EZ-Part V, Lines 38a-b; Schedule L, Part II	Loans to or from any ODTKE (e.g., loans to finance investment in or operation of a joint venture). Include loans that were originally between the filing organization and a third party but were transferred to an ODTKE.	Does not apply to advances under an accountable plan, charitable donation pledge receivables, accrued but unpaid compensation, and receivables in the ordinary course of business on the same terms as available to the general public.

Part/Schedule:	Applies To:	Exceptions/Notes:
[2] Core Form, Part IV, Line 27; Schedule L, Part III; Schedule O	Grant or other similar assistance (including goods, services and use of facilities) to any ODTKE, any substantial contributor or any person related to any of them. For example, advancing money for use by an ODTKE in investing in a joint venture with the filing organization with no expectation of repayment or free use of space for a joint venture owned 35% or more (stock of a corporation or profits interest of a partnership or limited liability company) ODTKE, substantial contributors or members of the filing organization's grant selection committee.	Does not apply to: (1) excess benefit transactions (see Schedule L, Part I); (2) loans (see Schedule L, Part II); (3) business transactions consistent with fair market value that serve the direct and immediate needs of the filing organization (e.g., reasonable compensation for services to the organization); (4) Section 132 fringe benefits; and (5) grants to an employee or child of a substantial contributor if awarded on an objective, non-discriminatory basis following pre-established criteria with review by a selection committee (see Regulations section 53.4945-4(b)).
[3] Core Form, Part IV, Line 28a-c; Schedule L, Part IV	ODTKE (and family members) with more than 35% ownership interest in any entity if that other entity has a direct or indirect (through any number of tiers or attribution) business relationship with the filing organization, including both joint ventures with and sales, leases, licenses and service agreements. For 501(c)(3) organizations, also include such arrangements with non-501(c)(3) organizations if an ODTKE of the filing organization was an ODTKE, partner, member or shareholder of the non-501(c)(3) organization.	Does not apply to: (1) ODTKE and family members own in the aggregate less than 35% (after attribution) of the entity doing business with the filing organization; (2) either the filing organization or the ODTKE owns 10% or less of the stock of the joint venture entity (if a corporation) profits and capital interests in the joint venture entity (if a partnership or limited liability company); (3) membership dues charged to directors and officers; (4) filing organization has a governing board with more than 20 voting members and an active executive committee that acts on behalf of the board, but this ''large board'' exception only applies if the ODTKE involved are not members of the executive committee, or officers, key employees or the top five highest compensated employees of the filing organization.
[4] Core Form, Part I, Line 2; Part IV, Line 32; EZ-Part V, Line 36; Schedule N, Parts II & III	Report any substantial contraction, including any sale, exchange or disposition of 25% or more of the assets of the filing organization such as by contributing or otherwise transferring those assets to a joint venture or a for-profit entity. Include both single transfers and series of transfers that exceed the 25% threshold, even if spanning multiple years (unless the facts and circumstances indicate otherwise – see Schedule N Instructions). Substantial contractions also include sales of assets by any joint venture in which the filing organization has an ownership interest.	Note, reporting obligations apply whether or not the filing organization received adequate consideration in return for the assets. Do not report (1) changes in passive investment portfolio, or (2) transfers to a disregarded entity of which the filing organization is the sole member. For dispositions accomplished over multiple tax years, an analysis of the facts and circumstances may indicate that in the aggregate there has been no substantial contraction. See Schedule N Instructions.
[5] Core Form, Part IV, Lines 34-35; EZ-Part V, Line 45; Schedule R, Parts II-V	Report transactions with related organizations. Schedule R defines ''related organizations'' as parents (controlling entities), subsidiaries (controlled entities), brother-sister (common control entities) and supporting/supported organizations (sections 509(a)(1) – (3)). Required disclosures include related exempt organizations (Schedule R-Part II), corporations (Schedule R-Part IV), partnerships (Schedule R-Parts III) and trusts (Schedule R-Part IV).	The following exceptions may apply: (1) With respected to disregarded entities, report those entities on Schedule R in Part I only. (2) Do not list subordinate organizations covered by a group exemption ruling in Schedule R, Part II (rather report the central organization's subordinates under Core Form, page 1, Item H(b), and explain the relationship to other groups in Schedule O if the filing organization is not covered by the same group exemption ruling). This exception does not apply to the required disclosure of related party transactions in Schedule R, Part V.
[6] Core Form, Part IV, Line 35; Schedule R, Part V, Line 2	Any transfers to an exempt, non-charitable ''related organization'' of the type described in Schedule R as summarize above in this table.	Note, this provision does not apply to transfers to (1) 501(c)(3) organizations, (2) 501(c)(4) organizations operated for charitable purposes, (3) 501(c)(10) organizations operated for charitable purposes, (4) 501(e) hospital cooperative service organizations, (5) 501(f) educational cooperative service organizations, or (6) 501(n) charitable risk pools.
[7] Core Form, Part IV, Line 37; Schedule R, Part VI	Exempt activities conducted through any partnership that is an unrelated organization (i.e., any partnership that is not a parent, subsidiary, brother/sister or supporting/supported organization).	Does not apply to (1) activities conducted by separate organizations that are treated as corporations for tax purposes regardless of the level of ownership or control; or (2) unrelated organizations the activities of which do not exceed 5% of the total activities of the filing organization as measured by either total assets or total revenues using, for the partnership, amounts reported on Form 1065, Schedule K-1 for the tax year ending within or simultaneously with the filing organization's tax year, if available.

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Part/Schedule:	Applies To:	Exceptions/Notes:
[8] Core Form, Part VI, Section A, Line 5; see also Schedules L & O; Core Form, Part IV, Lines 25a-b; EZ-Part V, Line 40b	Any ''material diversion'' of the filing organization's assets. Report here any unauthorized conversion or use of assets including embezzlement or theft. Explain in Schedule O. Include in Schedule L, Part I and Core Form, Part IV, Lines 25a or 25b, or EZ-Part V, Line 40b if an excess benefit.	This reporting obligation applies only if the assets diverted exceeded the lesser of $250,000 or 5% of the filing organization's gross receipts for its tax year, or 5% of its total assets as of the end of the tax year. In addition, the following transfers or uses are not material diversions: (1) uses in furtherance of the filing organization's purposes; and (2) authorized transfers for fair market value, including transfers to a joint venture in exchange for an equity or other interest in the joint venture.
[9] Core Form, Part VI, Line 16a; see also Instructions for Schedule R	Any contribution of assets to, or participation in, a joint venture or similar arrangement with a taxable entity (including individuals)	The filing organization is not required to report passive investment here, which include any joint ventures or other arrangements that meet both of the following conditions: (a) ''95% or more of the venture's or arrangement's income for its tax year ending with or within the organization's tax year is described in sections 512(b)(1)-(5) (including unrelated debt-financed income)''; and (b) ''[t]he primary purpose of the organization's contribution to, or investment or participation in, the venture or arrangement is the production of income or appreciation of property.'' Line 16a also is not applicable to joint ventures with other exempt organizations, whether or not related to the filing organization.
[10] Core Form, Part VI, Line 16b	Indicate whether there are written policies in place at the end of the filing organization's tax year requiring an evaluation of participation in JVs under federal tax law and safeguards taken to protect exemption with respect to such arrangements.	Note the Instructions for Part VI, Line 16b include examples of appropriate safeguards to be included in the policy; however, other safeguards may be appropriate in lieu of or in addition to those identified in the Instructions. The filing organization is encouraged to explain its policies in Schedule O.
[11] Schedule C	Report political campaign and lobbying activity conducted by a joint venture in which the filing organization has an ownership interest. This reporting obligation applies only if the joint venture is treated as a partnership for federal tax purposes. It applies whether or not the joint venture is controlled by the filing organization.	There is no exception currently provided in the Draft Instructions. Some commenters have suggested a reasonable period for correcting the joint venture's political activity by obtaining repayment, withdrawing from the joint venture, or improving the internal controls.
[12] Schedule H, Part IV	(*For Hospitals only.*) Any joint ventures providing health care management services to the filing organization or providing medical care or owning any property (including intellectual property) used by others in providing medical care.	Not required if the ODTKE or staff physicians of the filing organization, as of the end of the filing organization's tax year, own 10% or less of the stock of the joint venture entity (if a corporation) profits and capital interests in the joint venture entity (if a partnership or limited liability company). Consistent with the scope of Schedule H, Part IV also is not applicable to management services provided to third parties or to non-health care joint ventures.
[13] Schedule J, Part II; see also Schedule R	Include in Schedule J, Part II any compensation paid to any ODTKE by a joint venture that is a related organization as defined in Schedule R.	Do not include compensation that is paid by the joint venture if the joint venture is an unrelated organization, even if treated as a partnership for federal tax purposes.
[14] Schedule J, Part 1, Line 4c, 5a-b & 6a-b; see also Schedule R	Report whether any ODTKE receives any equity-based compensation from the filing organization or any related organization as defined in Schedule R (e.g., stock, stock options, stock appreciation rights, restricted stock, or phantom or shadow stock) or participated in any equity-based compensation plan sponsored by any such organization.	Note that although nonprofit corporations may not have true equity interests for state law purposes, this question also applies to compensation in the form of real or virtual equity in any other partnership, limited liability company or corporation.
[15] Schedule J, Part 1, Lines 5a-b & 6a-b; see also Schedule R	Report whether any compensation paid to any ODTKE is contingent on either revenues or net earnings of one or more activities of the filing organization or a related organization as defined in Schedule R.	Note that compensation is considered contingent if the amount is directly related to the level of revenues or net earnings (e.g., compensation equal to a percentage of such amounts). Payment of fixed dollar amounts that are payable only if the filing organization meets a revenue or net earnings target, however, are not considered contingent and are not reportable on Lines 5 or 6.

Part/Schedule:	Applies To:	Exceptions/Notes:
[16] Schedule K, Part III, Line 1	Report ownership tax-exempt bond financed property by certain joint ventures in which the filing organization participated.	Affected joint ventures are limited to (1) any partnership in which the filing organization was a general partner during the tax year, (2) any limited liability company of which the filing organization was a managing member during the tax year, and (3) any partnership or limited liability company in which the filing organization held more than a 50% profits or capital interest during the tax year.

Conclusion. The Form itself is final as released in December 2007 except for minor corrections such as typographical errors, and the Instructions are likely to be finalized by mid-July or August. Given the significant changes in the redesigned Form 990 and the complexity of the Draft Instructions, exempt organizations should strongly consider completing a mock Form 990 on the redesigned form based on 2007 information to assess possible disclosure issues and consequences before the new Form 990 takes effect for the 2008 tax year. This exercise can be especially beneficial for Schedule H, most of which is optional for 2008, and the various intertwined compensation disclosures. Organizations also should consider whether to conduct this mock return exercise under privilege to try to protect against discovery of the resultant work product by the IRS, state regulators, plaintiffs attorneys, unions or other interested adverse parties.

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