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

February 26, 2014

Ms. Sunita Lough
Commissioner
Tax Exempt & Government Entities Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Recommendations for Form 990, Schedule H, Part I, Line 7 Regarding De Minimis Joint Ventures for Hospitals

Dear Ms. Lough:

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to provide recommendations for de minimis treatment of joint ventures for hospitals as reported on Schedule H, Part I, Line 7 of Form 990, Return of Organization Exempt from Income Tax. These recommendations were developed by the AICPA Exempt Organizations Taxation Technical Resource Panel, and approved by the AICPA Tax Executive Committee.

Issue and Concern

The instructions to Form 990, Schedule H, Hospitals, require organizations to include joint ventures (JVs) in Line 7 of Part I when calculating the percentage that financial assistance and certain other community benefits represent as a percentage of total expenses. Due to the difficulties that organizations and their tax preparers encounter when attempting to obtain and compile the necessary data to accurately perform the calculation, we respectfully request that the Internal Revenue Service (IRS) consider implementation of a de minimis standard which permits exclusion of certain JVs where the burden of accuracy outweighs the benefits of transparency.

Recommendations

The AICPA respectfully recommends that you consider the following options, or a combination of these options, in regard to a de minimis standard for the reporting of JVs in the Line 7 percentage calculation. We believe these options would provide greater simplicity in reporting this information on behalf of hospitals:

1) Assume no financial assistance or other community benefits in the JV and determine the JV's impact on the percentage at the end of Line 7. We suggest treating the JV expenses amount as de minimis if a calculation both "with and without" the JV expense amounts would result in less than 0.5% decrease. – Although the option is

simple, the entity would need the expense information which is not readily available on the JV's Schedule K-1.

2) Treat the amount as de minimis if the percentage of the JV as part of the denominator is less than a specified percentage. We recommend a 5% threshold since this percentage has been used in various other areas of the form.[1] – Similar to option number one above, the entity will need expense information which is not readily available on the Schedule K-1.

3) Treat the amount as de minimis if the expenses do not exceed a specific dollar threshold. We recommend treating $250,000 in expenses, or less, as de minimis.

4) Treat the amount as de minimis if it does not exceed a threshold based on Schedule K-1 information, which sometimes nets expenses with income. – For example, if the Schedule K-1, Line 1, Ordinary Income is less than $100,000, it is considered de minimis. The advantage to this approach is that the entity (or its return preparer) can file accurately based solely on Schedule K-1 data if the expense information is not provided after inquiring. The disadvantage is that the Schedule K-1, Line 1, Ordinary Income line nets income with expenses and provides only a net number, therefore it is possible that much larger amounts of expenses are offsetting large revenue numbers to arrive at the less than $100,000 amount.

5) Assume any JV portion that is taxed as unrelated business income is considered irrelevant in the calculation.

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[1] 5% is used in the following areas of Form 990, Return of Organization Exempt From Income Tax:

<u>Part IV / Schedule D</u>
Line 11b – If more than 5% of total assets, go to Schedule D for Investments – Other Securities.
Line 11c – If more than 5% of total assets, go to Schedule D for Investments – Program Related.
Line 11d – If more than 5% of total assets, go to Schedule D for Other Assets.
Line 37 – Conducted more than 5% of its activities through a Partnership, go to Schedule R, Part VI.

<u>Part VI</u>
Line 1b – Independence test … 5%+ ownership in Partnership in which the board member belongs, triggers disclosure (Example 1).
Line 5 – Diversion of assets test … 5%+ of gross receipts or assets.

<u>General Instructions</u>
Section H – 5% of gross receipts can be part of the failure to file penalty.

<u>Schedule C</u>
Special Rules – There is a 5% de minimis rule on a person's time related to direct lobbying.

<u>Schedule L</u>
Part IV – 5% owner of another company used for interested person test.

6) Other – Develop other options regarding a de minimis standard for the reporting of JVs in the Line 7 percentage calculation that would provide greater simplicity in reporting this information on behalf of hospitals.

Example

To evaluate the merits of each of the alternative proposed factors above, we provide the following example:

Assume H Hospital (H) has $100,000,000 in total expenses (excluding both bad debts and the JV expenses). H has $9,000,000 in financial assistance and other qualifying community benefits.

H has an investment in an imaging JV. H owns 10% of the venture. The total revenue of the JV is $2,000,000. The total expenses of the JV are $1,750,000. Thus, the Schedule K-1, Line 1, Ordinary Income is $25,000 (($2,000,000 – $1,750,000) x 10% share). The footnotes to the Schedule K-1 state that $1,000 is unrelated business income.

Using the facts above, the following examples illustrate each of the alternative proposed factors:

1) Assume no financial assistance or other community benefits in the JV and determine the JV's impact on the percentage at the end of Line 7. We suggest treating the JV expenses amount as de minimis if a calculation both "with and without" the JV expense amounts would result in less than 0.5% decrease.

   In this example, the denominator is $100,000,000 *before* the JV and $100,175,000 *with* the JV. The percentage using $9,000,000 as the numerator swings from 9% without the JV to 8.98% with the JV. Since the impact of the JV without any financial assistance or community benefit is less than a 0.5% decrease to the ultimate percentage, this JV is disregarded and the entity would report $9,000,000 over $100,000,000.

2) Treat the amount as de minimis if the percentage of the JV as part of the denominator is less than a specified percentage. We recommend a 5% threshold since this percentage has been used in various other areas of the form.[2]

   In this example, the denominator before the JV is $100,000,000. Expenses of the JV are $175,000 ($1,750,000 x 10%) which is 0.18% of the denominator. Therefore, the JV would be de minimis and the entity would report $100,000,000 as the denominator.

3) Treat the amount as de minimis if the expenses do not exceed a specific dollar threshold. We recommend treating $250,000 in expenses, or less, as de minimis.

[2] *Id.*

In this example, the entity would treat the expenses of $175,000 as de minimis.

4) Treat the amount as de minimis if it does not exceed a threshold based on Schedule K-1 information, which sometimes nets expenses with income.

   In this example, if the Schedule K-1, Line 1, Ordinary Income is equal to or less than $250,000, it is considered de minimis. Under this option, the net income of the JV as reported on Line 1 of Schedule K-1 is $25,000 which is less than $250,000. Therefore, the JV is treated as de minimis.

5) Assume any JV portion that is taxed as unrelated business income is considered irrelevant in the calculation.

   In this example, the entity has $1,000 of unrelated business income and therefore can reduce the expenses of $175,000 by $1,000. Using $9,000,000 as the total financial assistance and other qualifying benefits, divided by $100,174,000, provides a percentage of 8.98%.

6) Other – Develop other options regarding a de minimis standard for the reporting of JVs in the Line 7 percentage calculation that would provide greater simplicity in reporting this information on behalf of hospitals.

As the example above demonstrates, in the interest of balancing transparency with burden, it is extremely burdensome for the entity to obtain the total revenue and expenses data when they do not have the tax return workpapers for the JV or have a minority interest in the JV. It is even more difficult to obtain the amount of the expenses that relate to financial assistance and other qualifying expenses for purposes of Schedule H. Most JVs are operated as partnerships and if the other partners are taxable organizations, it is rare for the books of the partnership to track financial assistance and other qualifying expenses.

<u>Conclusion</u>

The example above demonstrates that a small JV has a negligible impact on the ultimate Schedule H calculations for hospitals. Therefore, the AICPA respectfully requests that the IRS and the Department of the Treasury consider the implementation of one or more of the approaches discussed above, or other options, which help to simplify both the tax compliance and administration process. Allowing the treatment of certain JVs as de minimis and not requiring the inclusion of these JVs into the calculation of Schedule H, Part I, Line 7, will decrease the reporting burden and cost of compliance for exempt organizations that often face limited financial and accounting resources.

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We appreciate your consideration of these recommendations and welcome the opportunity to discuss these items further. If you have any questions, please feel free to contact Jeanne Schuster, Chair, AICPA Exempt Organizations Taxation Technical Resource Panel, at (617) 585-0373, or jeanne.schuster@ey.com; or Amy Wang, AICPA Technical Manager, at (202) 434-9264, or awang@aicpa.org.

Respectfully submitted,

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee