



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

September 16, 2015

Ms. Tamera Ripperda
Director, Exempt Organizations
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

RE: Top Three Comments on Form 990, *Return of Organization Exempt from Income Tax*, and Instructions

Dear Ms. Ripperda:

On June 17, 2015, the American Institute of CPAs (AICPA) submitted comments to you on Form 990, *Return of Organization Exempt from Income Tax*, and instructions.¹ Our submission was a compilation of comments previously submitted to the Internal Revenue Service (IRS) from 2008 to 2013 that have not yet been addressed by the IRS.

During our AICPA Exempt Organizations Taxation Technical Resource Panel (TRP) meeting on June 18, 2015 with the IRS, you requested that we provide our top three comments from the Form 990 comments matrix submitted on June 17, 2015. Accordingly, see below for our top three comments.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries, and a history of serving the public interest since 1887. 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.

If you have any questions, please contact me at (801) 523-1051, or tlewis@sisna.com; or Jeanne Schuster, Chair, AICPA Exempt Organizations Taxation Technical Resource Panel, at (617) 585-0373, or jeanne.schuster@ey.com; or Ogochukwu Anokwute, AICPA Lead Technical Manager, at (202) 434-9231, or [oanokwute@aicpa.org](mailto: oanokwute@aicpa.org).

Sincerely,

A handwritten signature in black ink that reads "Troy K. Lewis". The signature is written in a cursive, flowing style.

Troy K. Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: Ms. Donna Hansberry, Deputy Commissioner, TEGE, IRS

¹<http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2015-06-17-AICPA-Form-990-Comments-Matrix.pdf>.

**TOP 3 COMMENTS FROM
AICPA FORM 990 COMMENTS MATRIX
SUBMITTED TO THE IRS ON JUNE 17, 2015**

Section of the Form	Importance	Urgency	Comment	Recommendation
Instructions, Glossary	High	High	<p>Some organizations are misinterpreting the definitions of “control” in the case of a non-stock corporation. In the case of multiple, affiliated non-stock organizations with nearly identical board members, the organizations argue that “notwithstanding overlapping composition of boards of trustees, the trustees of X Charity, acting in that capacity, have no authority to remove, replace, or appoint a majority of the governing bodies of the other affiliates. The board of trustees of each affiliate, acting in its own independent capacity, periodically appoints its own new trustees.” We believe the last sentence of the definition of “control” applies as written (and note its parallel expression and result in Treas. Reg. § 1.512(b)-1(l)(4)(b)) and that it imposes “related organization” status between the two organizations regardless of whether parent-subsiary status was intended, as in these cases, a brother/sister relationship exists.</p> <p>Definition of “control”: In the case of a non-stock organization, the term “control” means that more than 50% of the directors or trustees of such organization are either representatives of, or directly or indirectly controlled by, an exempt organization. A trustee or director is a representative of an exempt organization if he or she is a trustee, director, agent, or employee of such exempt organization. A trustee or director is controlled by an exempt organization if such organization has the power to remove such trustee or director and designate a new trustee or director.</p>	<p>Please clarify the definitions of control and related organization (specifically, brother/sister organizations) in the glossary of the instructions.</p> <p>For example, the instructions can read: "Brother/Sister: an organization controlled by the same person or persons that control the filing organization..." followed by one of the possible options below: 1) “The same person or persons are deemed to control each organization simply by being voting members of each board.”, or 2) “When the two or more organizations share a majority of the same individuals, those organizations are deemed related.”</p>
Schedule D, Part V	High	High	<p>There has been much confusion among taxpayers as to the definition of "endowment funds" for purposes of this section. The reference in the instructions to SFAS 117 apparently is not sufficient to clarify that endowment funds reported in this section should comport with what is reported in taxpayer's audited financial statement "endowment" footnote.</p>	<p>Specifically state in the instructions that taxpayers with audited financial statements should report only those funds noted as "endowment" in their audited financial statements, rather than all of their temporarily and permanently restricted funds. See suggested language below:</p>

Suggested Language:

Schedule D, Part V, Line 1: An "endowment" is a fund intended to generate income for use in a project or activity, rather than a mere set-aside of principal for future use. An endowment may be a Board-designated fund ("quasi-endowment"), a temporarily restricted fund, or a permanently restricted fund. Its status as an endowment is dependent upon the intent with which it was set up, rather than on its restrictions. For example: funds designated as a reserve fund are not set aside for the purpose of generating income, as the principal is intended to be used as a "rainy day" fund. This type of fund, regardless of its classification, is not an endowment. Funds designated by an organization's Board of Directors that are set aside for the purpose of generating income each year, with the income used to fund annual operations, would be a Board-designated (or quasi) endowment.

Examples:

Example 1: Charity X has on its books Temporarily Restricted Fund A, that has been restricted for use in Program B. It is the intent of the donor that the principal of the fund be spent on Program B. Because the fund is not set up to generate income to used for Program B, Temporarily Restricted Fund A is a not an endowment.

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Example 2: Charity Y has on its books Permanently Restricted Fund C, which was set up via donor bequest. The donor's intent was that Charity Y preserve the principal of the fund in perpetuity, with earnings from the fund spent on Program D. Because this fund was set up with the intent to generate operational income, Permanently Restricted Fund C is a permanent endowment.

Example 3: Charity Z has on its books Board-Designated Fund E, which has been designated by Charity Z's Board of Directors to help fund its operations. It was the intent of the Board, in setting up the fund, that the principal amount of the fund be left intact. Income from the fund would be used to help fund operation of Charity Z's Program F. Because this fund was set up with the intent to generate operational income, Board-Designated Fund E is a quasi-endowment.

If an organization has received a set of GAAP audited financial statements for the tax year, its endowments are already laid out in its "Endowment" footnote. Accordingly, the organization's endowment disclosure for Part V of Schedule D will be the same as its disclosure in its audited financial statements.

Schedule D, Part V, Line 2: Under GAAP, there are 3 types of endowments: *board designated (quasi-endowment)*; *permanent*; and *term*. Each type can have different net asset classes. The name of the endowment type refers to the restriction placed on the principal of the endowment, as outlined in the chart below:

		A	B	C
Type	Who Restricts?	Net Asset Class of <u>Principal Balance</u>	Net Asset Class of <u>Accumulated Income Balance</u> (Above water)	Net Asset Class of <u>Accumulated Loss Balance</u> (Under water)
Permanent (Traditional)	Donor Restricted	Permanently Restricted	Temporarily Restricted (Time Restricted)	Unrestricted (Designated)
Term	Donor Restricted	Temporarily Restricted (Time Restricted)	Temporarily Restricted (Time Restricted)	Unrestricted (Designated)
Board-Designated (Quasi)	Board Designated	Unrestricted (Designated)	Unrestricted (Designated)	Unrestricted (Designated)

The total endowment balance for *each fund* equals $A + B$ or $A - C$. For permanent and term endowments, a temporarily restricted balance and an unrestricted balance on accumulated income/loss may not exist simultaneously - it is either one or the other. Furthermore, each individual fund must be analyzed separately. Accordingly, an organization's total permanent endowment balance might have all three net asset classes, if some individual permanent endowment funds are above water and some funds are under water.

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Schedule R, Instructions	High	High	<p>The definition of control of a nonprofit (as defined in the Glossary to the Form 990) includes the following statement: "also, a (parent) organization controls a (subsidiary) nonprofit organization if a majority of the subsidiary's directors or trustees are trustees, directors, officers, employees, or agents of the parent." This definition of control includes situations where there is coincidental overlap (i.e. there is no right or ability of one organization to appoint or remove board members of the other). While the organizations may be related, there appears to be no element of control in these situations.</p>	<p>At conferences and in conversations with the IRS, IRS personnel have indicated that there is coincidental overlap when each organization is the controlled and controlling entity. With coincidental overlap, there is no control. This presentation on the Form 990 may be confusing to the reader in understanding the true nature of the organizations' relationship.</p> <p>The IRS should modify the instructions to state that in cases where there is coincidental overlap of board members, each organization should report the other entity as "related" using Schedule R. However, neither organization is a controlled or controlling entity.</p>
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