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## IRS Releases Draft Form 990 Instructions for Comment

In response to congressional pressure to make the operations of the exempt organizations more transparent, the IRS proposed broad changes in June 2007 to the Form 990 informational return filed annually by exempt organizations. After receiving approximately 3,000 pages of written comments on the proposed form, the IRS released the new 2008 Form 990 that was based on the proposed draft but included numerous changes and clarifications in response to the comments. On April 7, 2008, the IRS released for public comment the draft instructions for the new Form 990. In an effort to ensure that the final instructions address the needs of the tax-exempt community, the IRS is accepting public comments until June 1, 2008.

The redesigned Form 990 consists of a core form and several new schedules. Parts I through XI of the form must be completed by all filing organizations, and requires reporting on the organization's exempt and other activities, finances, governance, compliance with certain federal tax filings and requirements, and compensation paid to certain persons. Exempt organizations will need to complete additional schedules depending upon their

respective activities, operations, finances and structure.

The IRS has indicated that the purposes of the new Form 990 are to enhance transparency in order to provide the government and the public with a realistic picture of the tax-exempt organization, to promote compliance by accurately reflecting the organization's operations, and to minimize the burden on filing organizations. The draft instructions will help to provide some insight on how the IRS anticipates that exempt organizations will report information on Form 990.

The new Form 990 and its instructions will apply to the 2008 tax year for returns filed in 2009. Schedules H and F, which apply to hospitals and tax-exempt financing disclosures, will be phased-in over 2008 and 2009. The draft Form 990 instructions are organized according to a consistent format, including a general overview of the form or schedule explaining its purpose, an explanation of who is required to file that particular schedule, and then line-by-line instructions to aid in answering each question on the form or schedule.



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In response to comments received based on the draft Form 990, the draft instructions include new tools designed to make it easier for the organization to answer the questions and to promote more uniform reporting. Such tools include a comprehensive glossary of terms, a sequencing list to help organizations determine the order in which to fill out parts of the form, a compensation table to help organizations determine how and where to report items of compensation, and several illustrative examples. In addition, the IRS has drafted separate instruction sections for the core form and each schedule.

Since the box for group exemption information was excluded from the draft Form 990 proposed in June 2007, there was some concern that the IRS would be eliminating group exemptions and/or the ability to file consolidated returns for groups. The instructions, however, indicate that the IRS has not eliminated the use of group returns. Specifically, parent organizations may still file a consolidated Form 990 for two or more subordinate organizations if the subordinate organizations (1) are affiliated with the central organization at the time that the annual accounting period ends, (2) are subject to the central organization's general supervision or control, (3) are exempt from tax under a group exemption that is still in effect, and (4) use the same accounting period as the central organization. A subordinate organization covered by a group ruling may file a separate return instead of being included in the group return if it so chooses. If the central organization is required to file a return, it must do so separately and not as a part of a group return.

Of particular interest to healthcare organizations are the draft instructions on governance, executive compensation, and the new Schedule H. The instructions provide valuable

insight on responding to Part VI of the core form on the governance of exempt organizations. The terms governing body, voting member, independent voting member, material financial benefit, and material diversion of assets are defined. The instructions clarify that the independence of a board member is not jeopardized merely because a board member is a major donor or receives material financial benefits solely in the capacity as a member of an organization. The IRS is specifically requesting additional examples regarding when a board member should be deemed "independent." There is also specific instruction regarding reporting changes to organizational documents, material diversion of assets, conflicts of interest, providing a copy of the Form 990 to the governing body, and joint venture investment policies. Such changes should be reported in Schedule O.

The instructions also provide useful insight on the executive compensation information required in Part VII of the core form and in Schedule J. The term "key employee" is defined to include individuals with overall responsibilities for the organization as a whole, as well as individuals who manage or have authority to control more than five percent (5%) of the organization's activities, assets, income, expenses, capital expenditures, operating budget, or compensation for employees. An organization is only required to list those key employees whose compensation exceeds \$150,000. The instructions provide special rules for treating officers, directors, and employees of disregarded entities as key employees or highest compensated employees of the filing organization. The instructions indicate that other compensation includes health and retirement plan benefits, and other benefits if they exceed \$10,000 in



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value per year, per type of compensation. Nontaxable benefits excluded under Section 132 are not included when calculating compensation. The instructions further explain that the top five (5) highest compensated employees who are paid over \$100,000 includes individuals who are key employees but who need not be listed as key employees because their compensation is less than \$150,000. The Schedule J instructions provide additional clarification on items that should be treated as fringe benefits and how deferred compensation amounts should be reported.

Schedule H is one of the new schedules added to the 2008 Form 990 and is to be completed by hospitals. For the 2008 tax year, only Part V of Schedule H seeking "facility" information is required. "Facilities" include a campus (or component theory) building, structure, or other physical location or address at which the organization provides medical or hospital care, including a hospital, outpatient facility, surgery center, urgent care clinic, or rehabilitation facility, whether operated by the organization or through a disregarded entity or joint venture taxed as a partnership. The remainder of Schedule H does not need to be completed until tax year 2009.

The instructions define a "hospital" as a facility that is licensed or certified as a hospital under state licensing and certification laws. Based on state licensure laws, this may include certain facilities licensed as a hospital but reimbursed by Medicare as an ambulatory surgery center or another type of provider. "Hospitals" includes entities that are operated through disregarded entities and joint ventures taxed as partnerships, but does not include hospitals that are operated by a separate tax-exempt or taxable corporation. If the organization operates multiple hospitals, or if it files a group return for a group that operates one or more

hospitals, only one Schedule H is to be completed for all of the hospitals and the information is reported in the aggregate.

Part I of Schedule H seeks information on charity care and other community benefits provided by the hospital. The instructions to Schedule H define the terms charity care policy, charity care, and medically indigent, and provide IRS worksheets that can be used to report community benefit. The instructions clearly indicate that bad debt is not "charity care" and may not be reported in Part I of the schedule. Use of the IRS worksheets is not required, and it is not necessary for an organization to file the worksheets with the Form 990, but the organization is required to maintain the documentation to substantiate the information reported in the schedule.

Part III of Schedule H requires a hospital to report aggregate bad debt expense, provide an estimate of how much bad debt expense is attributable to persons who qualify for financial assistance under its charity care policy, and provide a rationale for what portion of bad debt it believes should constitute a community benefit. Revenues and expenses relating to Medicare Parts A and B are also reported in this section.

Part IV of Schedule H seeks information regarding management companies and joint ventures. Reporting of joint ventures and management companies of which the organization is a partner/shareholder is only required if the organization's officers, directors, trustees, key employees, or physicians who have staff privileges with one or more of the organization's hospitals own in the aggregate more than ten percent (10%) of the partnership profits or stock of the corporation. The instructions provide examples of the types of joint ventures for which the IRS is seeking information including



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ancillary joint ventures formed by the organization and its officers or physicians to conduct an exempt or unrelated business activity, a company owned by the organization's officers or physicians that owns and leases to the organization a hospital or other medical facility, or a company that owns and leases to entities other than the organization diagnostic equipment used to provide medical care.

The IRS is seeking comments on how filing organizations should report the cost of Medicaid, provider taxes, and revenue from uncompensated care pools or programs as costs and revenues associated with charity care. The IRS would also like comments on whether filing organizations should report data from foreign hospitals on Schedule H and on whether the Schedule H worksheets can be further simplified or streamlined. Finally, comments are requested on whether and under what circumstances subsidized health services should include any portion of costs to conduct a physician clinic or skilled nursing facility.

Other schedules of interest to healthcare providers may include K and R. Schedule K will be used by an organization to provide information on outstanding liabilities associated with tax exempt bonds for each outstanding tax-exempt bond issue which has both an outstanding principal amount in excess of \$100,000 as of the last day of the tax year and was issued after December 31, 2002. For this schedule, any refundings after 2002 of pre-2003 issues must be treated as post-2002 issues and reported on Schedule K as well. The instructions define "tax-exempt bond" as an obligation issued by or on behalf of a governmental issuer on which the interest paid is excluded from the holder's gross income under Section 103 of the Internal Revenue Code. The instructions indicate that for tax year 2008, Part I on bond issues is the only part of Schedule K that must be completed when Schedule K is

required. The remaining sections of the schedule seeking information on how proceeds are used and invested, private business use, and arbitrage are not required until tax year 2009.

Schedule R will be used by organizations to provide information on related organizations, on certain transactions with related organizations, and on certain unrelated partnerships through which the organization conducts significant activities. The instructions define various relationships between the entities (parent, subsidiary, brother/sister, supporting/supported) and provide a definition of control. Interestingly, the instructions note that disregarded entities are treated as related organizations for purposes of Part I of the schedule, but not for purposes of reporting transactions with related organizations in Part V of the schedule or in the rest of the core form. The instructions further indicate that an organization that is part of a group exemption ruling is not required to list any of the subordinate organizations of the group in Schedule R, Part II. Even if a related organization is not required to be listed in Part II, the organization must still report its transactions with the related organization in Part V.

While comments may be submitted on all aspects of the draft instructions, the IRS has specified certain areas in the instructions where it is requesting public comment, as well as in the "highlights" portion of each component of the instructions. The IRS also requests comments on the glossary definitions and on the new and significantly revised areas such as compensation, governance, foreign activities, disregarded entities and joint ventures, group returns, hospitals, and tax-exempt bonds. Finally, the IRS is asking for comments on the development of lists of items for particular sub-sectors to report in Part III, Statement of Program Service Accomplishments (in the Core Form), for more uniform reporting of program



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Comments on the draft instructions to the new IRS Form 990 must be submitted by June 1, 2008 and may be e-mailed to the IRS at [Form990Revision@irs.gov](mailto:Form990Revision@irs.gov) or sent by U.S. Mail. If you would like assistance on commenting on the

proposed instructions, please contact James M. Daniel, Jr. or Michael R. Newby, who are attorneys in the HDJN Richmond, Virginia office, by telephone at 804.967.9604 or by e-mail at [jdaniel@hdjn.com](mailto:jdaniel@hdjn.com) or [mnewby@hdjn.com](mailto:mnewby@hdjn.com).

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