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Update on New IRS Form 990 Return for Exempt Organizations

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In December 2007, the Internal Revenue Service released its final version of the new Form 990, the annual return for tax-exempt organizations, to be used for fiscal year 2008 and beyond. In April, the IRS released for comment its draft instructions for completing the new form. The public comment period closed on June 1, 2008, and the IRS will finalize the instructions by the end of the year. The new form is part of an effort to achieve greater transparency on the part of tax-exempt organizations. It will require significantly increased reporting of not only financial information but also internal governance and policy information. This is an update on the new Form 990, with recommendations on preparing for its use.

The IRS requires most trade associations, professional societies, cause organizations, charities, and other tax-exempt nonprofits to file Form 990 annually. The IRS had not updated the form since 1979 and was prompted to do so in part as a result of reports of abuse of tax-exempt status by some organizations. The stated goals of the new form are to enhance transparency for the government and the public, to promote tax compliance by accurately reflecting an exempt organization's activities, and to minimize organizations' filing burdens.

The new Form 990 includes an 11-part core form, the first page of which is a summary, and 16 supplemental schedules regarding specific organizational activities and financial information. The updated form requires increased reporting in areas such as governance, compensation, tax-exempt bonds, foreign activities, and non-cash contributions.

For each schedule, the draft instructions provide an overview of its purpose, an explanation of who is required to file it, and line-by-line instructions. Additions to the Form 990 instructions, created in response to public comments on the draft Form 990, include a glossary of 176 key terms used in the form, a sequencing list to assist organizations in deciding the order in which to complete parts and schedules of the form (found in the general instructions), and a compensation table to help organizations determine what items of compensation and benefits to report and where (found in the instructions for Part VII).

Summary of Key Changes

The most notable theme emerging from the changes to Form 990 is a demand for more detailed information about the internal governance and policies of tax-exempt organizations. Another major change is increased reporting of compensation and benefits for highly-paid employees.

Governance

In Parts I and VI of the core form, organizations must report the number of voting board members as well as the number of "independent" voting board members. According to the glossary of terms, an "independent member of governing body" is a board member who does not receive officer or employee compensation or other material financial benefits from the organization or a related organization and does not have a family member who receives such compensation or benefits. Under this definition, an organization's chief executive officer serving as an ex officio voting or non-voting member of the board is not an independent director by virtue of being compensated as an employee. A board member still may be considered independent if the member receives reasonable reimbursement for expenses, reasonable compensation for service as a board member, or up to $10,000 as an independent contractor.

Section A of Part VI requires more detailed information about organizations' governing bodies and management practices. Organizations must report any family or business relationships among officers, directors, trustees, and key employees. Schedule L must be completed if any officers, directors, trustees, or key employees—or their family members—have a business relationship with the organization. The IRS, after considering feedback from organizations, defined "key employee" in the draft instructions as an employee earning at least $150,000 who has "responsibilities, powers, or influence" similar to those of an officer, director, or trustee; "manages a discrete segment or activity" that represents at least five percent of the organization's activities, assets, income, or expenses; or "has or shares authority to control or determine" at least five percent of the organization's capital expenditures, operating budget, or employee compensation. As the instructions are now drafted, this could include a number of management employees whose salaries are not currently subject to disclosure.

Organizations also must indicate in Part VI, Section A, whether they have delegated any management duties normally performed or supervised by officers, directors, trustees, or key employees (such as to an executive committee); whether they take contemporaneous minutes of board of directors and board committee meetings; and whether they showed their completed Form 990 to the governing board before they filed it. Although the new instructions do not create a mandate to do so, this provision makes it advisable for an organization to circulate copies of its Form 990 to its directors each year before filing.

Policies

The new Form 990 asks a series of questions about whether organizations have instituted certain types of policies. In Part VI, Section B, organizations must report on the existence of written policies for the following: (1) conflicts of interest; (2) whistleblower protection; (3) document retention and destruction; (4) objective determination of compensation of the organization's CEO or Executive Director and other officers or key employees; and (5) tax exemption ramifications of joint ventures or similar arrangements with taxable entities, if they exist. Many exempt organizations already have policies in place addressing some of these subjects, but few, if any, organizations have already adopted all five of these policies, particularly with the scope and content that the IRS describes.

These questions reflect the IRS's best practices recommendations, and although the IRS has not mandated the establishment of such policies, it is possible that organizations answering "no" to the policy questions could receive more scrutiny from the IRS. As a result, it would be advisable for organizations to adopt all five of these policies within their 2008 fiscal years.

Compensation

Part VII of the new Form 990 requires organizations to report the compensation of all current officers, directors, and trustees, regardless of the amount. Organizations also must report the compensation of current key employees; the five highest compensated non-key employees if they earn more than $100,000; former officers, key employees, and highest compensated employees if they earned more than $100,000 during the reporting year; and the five highest compensated independent contractors, either organizations or individuals. Although the language of Part VII, Section A, of the form itself suggests that key employees should be listed regardless of compensation amount, the draft instructions have clarified that the $150,000 minimum compensation is now a part of the definition of "key employee."

Organizations that list in Part VII any individual with a total compensation greater than $150,000 must complete Schedule J, which requests detailed category-specific information about compensation and benefits for highly paid individuals. Schedule J asks about benefits such as travel, housing allowances, discretionary spending accounts, and personal services, and asks whether the organization has a written policy regarding the payment or reimbursement of such expenses. Schedule J also asks for a breakdown of the compensation for each individual into the following categories: base compensation, bonus and incentive compensation, other current-year compensation, deferred compensation, and nontaxable benefits.

Recommendations

In preparation for filing the new Form 990 next year, tax-exempt organizations should consider taking the following actions:

- Identify any "non-independent" voting members of the governing board for Part I and Part VI, Section A.
- Estimate the total number of "volunteers" for Part I.
- Ensure preparation and maintenance of contemporaneous minutes for meetings of the governing board and governing board committees (i.e., Executive Committee) for Part VI, Section A.
- Identify or create policies and procedures for chapters, branches, and affiliates for Part VI, Section A.
- Develop a process for sharing the draft or final completed Form 990 with the governing board.
- Identify or create governance policies addressed in Part VI, Section B:
    - conflicts of interest;
    - whistleblower protection;
    - document retention and destruction;

    - objective determination of compensation of the organization's CEO or Executive Director and other officers or key employees; and

    - tax exemption ramifications of joint ventures or similar arrangements with taxable entities, if they exist.

- Consider whether government documents, conflicts policy, and financial statements will be disclosed to the public for Part VI, Section C.

- Identify officers, directors, trustees, key employees, highest compensated employees, and independent contractors for Part VII, Sections A and B, and ensure tracking of total reportable W2/1099 compensation.

- Ensure that several reportable forms of compensation are being tracked for the individuals identified in Part VII, in anticipation of providing compensation breakdowns in Schedule J.

- Ensure tracking of entertainment or travel expenses on behalf of federal, state, or local public officials for Part IX, Item 18, in view of new federal-level prohibitions on expenditures with potential criminal penalties.

The new Form 990 may be a significant burden for many organizations, particularly small organizations. It is strongly advisable to take action now to address these new requirements.

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