



TAX PLANNING

THE NEW FORM 990: REVOLUTION IN PROGRESS

The practical consequences of the Form 990 revision for tax exempts, their board members and those who advise them

Grace Allison
Tax Strategist
Northern Trust

Reprinted with
permission from *Estate
Planning*, Vol. 37, No. 2,
Thomson Reuters/RIA,
© 2009, Northern Trust
Corporation.

In 2008 the IRS unveiled a dramatically new version of Form 990, the voluminous tax form historically filed by over 200,000 large tax-exempt entities, including publicly-supported charities, social welfare organizations, chambers of commerce and associations like the National Football League.¹ At the heart of the new Form is the assumption that good governance at the board level – coupled with the adoption, implementation and disclosure of policies and procedures – fosters tax compliance and promotes public confidence.² This article will examine some of the practical consequences of the Form 990 revision (and the related IRS-private sector debate) for tax exempts, their board members and those who advise them.

FILING THRESHOLDS

As in the past, the filing threshold for Forms 990 is generally based on the magnitude of an organization's gross receipts and assets. Organizations too small to be required to file a Form 990 are permitted to file the much simpler, four-page Form 990-EZ, while the very smallest organizations (e.g., gross receipts less than \$25,000 for 2009 – and less than \$50,000 for 2010) are required only to file Form 990-N, the e-Postcard.

In 2007 organizations were required to file Form 990 if they had either (i) gross receipts of \$100,000 or more or (ii) assets of \$250,000 or more. When fully phased in, the new rules double these threshold amounts, i.e. for the 2010 tax year, entities will be required to file Form 990 only if they have (i) gross receipts of \$200,000 or more or (ii) assets of \$500,000 or more.

As shown in the chart below, the transition rules are intended to give certain organizations (those with gross receipts between \$200,000 and \$500,000 and assets between \$500,000 and \$1,250,000) a two-year grace period before they are required to file the revised Form. Those organizations can file Form 990-EZ for 2008 and 2009, but must file Form 990 for 2010 and thereafter. Similarly, organizations with gross receipts between \$500,000 and \$1 million and assets between \$1.25 million and \$2.5 million have a one-year grace period, filing Form 990-EZ for 2008 but Form 990 for 2009 and thereafter.

MAY FILE 990-EZ FOR:	IF GROSS RECEIPTS ARE:	AND IF ASSETS ARE:
2008 Form (generally filed in 2009)	< \$1,000,000	< \$2,500,000
2009 Form (generally filed in 2010)	< \$500,000	< \$1,250,000
2010 and later Forms	< \$200,000	< \$500,000

The Internal Revenue Service estimates that, under this regime, about 76% of all exempt organizations will be eligible to file the Form 990-EZ for their 2008 tax year, 68% for 2009 and 51% for 2010.³

CONTINUED



Practical tip #1: *If you are a board member or an advisor for a tax exempt, determine if – and when – your organization is required to file the new Form 990. Significantly, the IRS reports that of the first 6,000 entities filing Forms 990 for 2008, most could have filed the simpler Form 990-EZ.⁴*

Practical tip #2: *If the organization will be filing Form 990-EZ, determine which, if any, of the new Form 990 Schedules will be required. Organizations filing Form 990-EZ may be required to file up to seven additional Schedules from the revised Form 990, i.e. Schedules A-C, E, G, L and/or N.*

OUT WITH THE OLD...

If you determine that the revised Form 990 (or one of its Schedules) will be a fact of life for you as a board member or advisor, your first question is likely to be “Exactly how different is the new Form from the old?” The old Form 990, with only two Schedules (A and B), was heavily focused on financial information. For example, Part I asked for a statement of “Revenues, Expenses and Changes in Net Assets”; Part II, a “Statement of Functional Expenses”; Part IV, a “Balance Sheet”; and Part VII, an “Analysis of Income Producing Activities.” In contrast, the new Form starts with a question about Mission and (other than an introductory summary) puts financial schedules at the back of the Form in Part VIII (“Statement of Revenue”); Part IX (“Statement of Functional Expenses”), and Part X (“Balance Sheet”).

The old Form 990 included a catch-all Part VI (“Other Information”), a disorganized mishmash covering everything from foreign bank accounts to lobbying. The new Form 990 is both more tightly organized and even broader in scope, requiring all reporting organizations to complete an 11-page “Core,” together with one or more of 16 associated Schedules (see “Anatomy of the Revised Form 990,” page 7). The exact number of Schedules required depends in part on the nature of the organization’s operations. There is, for example, a new Schedule F on which to report activities in foreign countries, a new Schedule H for hospitals and a new Schedule K for tax-exempt bond issues. Other new Schedules

target the types of transactions that may raise excess benefit concerns, such as compensation (Schedule J), loans to insiders (Schedule L) and fundraising (Schedule G).

The Core and its Schedules have already proven to be a formidable challenge.⁵ To help preparers navigate (and to ensure that no requirement is overlooked), a 37-item “Checklist of Required Schedules” is incorporated in the Core as new Part IV, while new Part V provides a handy listing of other related and potentially required filings, ranging from TD F 90-22.1 (Report of Foreign Bank and Financial Accounts) to Form 8886-T (Disclosure by Tax-Exempt Entity Regarding Prohibited Tax Shelter Transaction). Also critical is Part C of the Instructions, “Sequencing List to Complete the Form and Schedules,” which warns that “[c]ertain later parts of the Form must first be completed in order to complete earlier parts.”⁶

Additional resources are available through the “Charities and Non-Profits” page of the IRS Web site (irs.gov). Perhaps the most helpful is the online instructional video series “The New Form 990: Getting Started” that addresses typical preparation issues through an engaging case study format.

GOVERNANCE, MANAGEMENT AND DISCLOSURE

As noted above, the very first question posed by the Core – “Briefly describe the organization’s mission or most significant activities” – puts the reader on notice that the revised 990 is more than a numeric compilation of revenues, expenses and assets. New approaches typically stir controversy, and the most controversial portion of the Core is new Part VI. Titled “Governance, Management and Disclosure,” Part VI houses an entire litany of good governance inquiries – and was described by former Tax Exempt/Government Entity Commissioner Steven T. Miller as the “crown jewel” of IRS efforts in the governance arena.⁷ Part VI, Section A is comprised of 11 questions about “Governing Body and Management”; Section B, five questions about “Policies” and Section C, four questions about “Disclosure.” Commentators have

generally been concerned that the IRS will seize on any “nonconforming” answers as evidence of poor governance, creating a “one size fits all” compliance mentality.⁸

Governing Body and Management

The first two questions in Part VI, Section A focus on the “independence” of the nonprofit’s “governing body,” “officers” and “key employees,” each a term defined in the 75-page Core Instructions, which include a 15-page Glossary. Line 1b of Part VI,

Section A is best described as deceptively simple (“Enter the number of voting members that are independent”); it is followed by the more obviously demanding question in line 2:

“Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee or key employee?”

Turning to the Instructions, advisors will learn that a member of the governing body is “independent” only if she meets a three-pronged test, i.e. only if she

1. Was not compensated as an officer or other employee of the organization or of a related organization; **and**
2. Did not receive total compensation or other payments exceeding \$10,000 during the organization’s tax year from the organization or from related organizations as an independent contractor, other than reimbursement of expenses under an accountable plan or reasonable compensation for services provided in the capacity as a member of the governing body; **and**
3. Was not directly or indirectly involved (and in addition no family member was directly or indirectly involved) in a transaction that is required to be reported on Schedule L for the organization’s tax year, or in a transaction with a related organization that is reportable on Schedule L required to be filed by that organization.⁹

Under this definition, an estate planning attorney serving as a Board member of an exempt organization will not be “independent” in any year in which he receives more than \$10,000 from the organization for legal services rendered to it, even if those fees represent an insignificant percentage of his total client billings.

Practical Tip #3: *Whether you are preparing the Form 990 or advising a tax-exempt’s Board, there is no substitute for reading the Core, the accompanying Schedules and the Instructions in their entirety.*

What about the definitions of “family relationship” and “business relationship” in Part VI, Section A, line 2? They, too, are found in the Instructions and are predictably complex. An additional problem is that most tax-exempts are not privy to detailed information about the family and business connections of officers, directors, trustees and key employees. How deeply must a tax-exempt probe? In this particular circumstance, the IRS is willing to provide a “reasonable efforts” safe harbor:

“The organization is not required to provide information about a family or business relationship ... if it is unable to secure the information after making a reasonable effort to do so.”

According to the Instructions, an example of “reasonable effort” is the distribution of an annual questionnaire “that includes the name, title, date, and signature of each person reporting information and contains the pertinent instructions and definitions for line 2.”¹⁰ One can only wonder how a typical officer, director, board member or key employee could, without legal counsel of her own, deal with such a questionnaire. Informal reports from tax-exempts indicate that, for many directors and board members, hasty resignation is a preferred response.

Practical Tip #4: *Organizations should carefully consider how to prepare personnel for a “safe harbor” questionnaire.*

Policies

The strong governance theme of Part VI, Section A continues in Part VI, Section B. Here, each reporting organization is asked whether it has:

- A written conflict of interest policy that requires officers, directors, trustees and key employees to disclose every year any interests that could give rise to conflicts;
- A written whistleblower policy; and
- A written document retention and destruction policy.

The Instructions clarify that questions about “governance, management and disclosure” can only be answered “yes” for the current tax year if the relevant policies and procedures are in fact adopted by the Board before the end of that year.¹¹

Practical Tip #5: *Before year end, tax-exempts required to file Form 990 – along with their directors and advisors – should spend appropriate time reviewing the adequacy of their organization’s current governance policies and procedures. As part of that process, it may be helpful for Board members or staff to review a selection of model documents at the Independent Sector (independentsector.org) or BoardSource (boardsource.org) Web sites. Remember, too, that it is critical to put existing policies into practice. In Commissioner Miller’s words, “The mere adoption of written policies and procedures does not mean that they are being used.”¹²*

Other questions in the “Policies” section demonstrate a keen interest in process:

“Describe the process used to determine compensation of the organization’s top management official, other officers and key employees”

and

“Describe the process, if any, the organization uses to review the Form 990.” (Italics added.)

Like the answers to other essay-style questions on the Form, the answers to these questions must be recorded on Schedule O, a blank Schedule designed

for this purpose. Schedule O is a required attachment for all preparing the new Form 990.

Practical Tip #6: *An accountant or tax planner cannot complete the new 990 without careful consultation with key staff and board members. Answers appearing on Schedule O, in particular, should be constructed with an awareness that they will be read not only by the IRS but also by potential grant makers.*

Disclosure

Part VI, Section C includes not only questions about state filings and the location of books and records, but also an essay-style question (answer to be recorded on Schedule O) asking “whether (and if so, how) the organization makes its governing documents, conflict of interest policy and financial statements available to the public.” Significantly, “website” is among the possible disclosure options listed in Section C. It is reasonable to imagine that many organizations will be encouraged by this question to enhance their existing Web sites with postings of policies, procedures and financials. A collateral consequence is likely to be wealth of new information for grant making entities such as private foundations.

GOVERNANCE QUESTIONS BEYOND PART VI

The basic governance questions in Part VI of the Core apply to all nonprofits required to file Form 990. Other questions on the new Form are tailored to address specialized governance concerns.

- Organizations receiving non-cash contributions are asked in Schedule M (NonCash Contributions) if they have a gift acceptance policy that requires review of any non-standard contributions.
- Organizations holding conservation easements are asked in Schedule D if they have a written policy regarding the periodic monitoring, inspection and enforcement of those easements.
- Organizations that provided first-class travel to directors, officers or key employees are asked on Schedule J if they followed a written policy for such payments or reimbursement.

COMPENSATION OF ALL TYPES: PART VII AND SCHEDULE J

A second area of increased scrutiny in the new Form 990 is compensation. The daunting six-column chart in Part VII, Section A requires a listing (for each “current” and “former” “officer,” “director,” “trustee,” “key employee” and “highly compensated employee”) of “reportable compensation” from the organization and any “related” organization – as well as an estimate of “other compensation” – with a variety of reporting thresholds. This compendium is supplemented by additional questions and an even more complicated chart on Schedule J, Part II, which requires breaking compensation down into six component categories, including “base compensation,” “bonus and incentive compensation,” “other compensation,” “deferred compensation,” “nontaxable benefits” and “previously reported compensation.” It is telling that the Instructions include yet another chart, this one advising where to report 69 different types of compensation, ranging from salary to social club dues.¹³ As stated by the IRS in a Background Paper, the goal here is to create uniformity “regarding how, when and where to report various types of compensation.”¹⁴ One consequence of this uniformity is that the IRS should find it easier to make comparisons and identify outliers – which is important in an area where reasonableness is determined by comparable business practice.

In Part VII, as in Part VI, definitions are crucial. The term “officer,” for example, includes not only those elected as such, but also the organization’s “top financial official” and its “top management official,” each a separate defined term.¹⁵ Similarly, a “key employee” includes only those who meet a three-part test set out in the Glossary, while the identity of “former” officers, trustees, etc. is determined using a five-year look-back period described elsewhere in the Instructions.¹⁶

One particularly difficult task for organizations and preparers alike is gathering information on payments made to specified individuals from a “related” organization, which, of course, includes determining which organizations are in fact “related.” Under the definitions set forth in the Glossary, the essence of being “related” is the type of control that one entity

exerts over the other. For example, the power to remove and replace a majority of the nonprofit organization’s directors or trustees is the kind of control that would indicate a parent-subsidiary relationship.¹⁷ Once again, the Instructions provide a “reasonable efforts” exception for organizations that successfully secure an executed questionnaire from the specified individuals.¹⁸

In addition to the new Form 990’s questions about compensation from related organizations, there is a new question (Part VII, Section B, line 5) on compensation from unrelated organizations. The IRS is concerned that

“some organizations have attempted to structure compensation arrangements through unrelated organizations to circumvent the prior Form’s reporting of executive compensation paid by the filing organizations and its related organizations.”¹⁹

Any compensation from an unrelated organization must generally be reported both on Part VII and on Schedule J. There are, of course, special exceptions. Most pertinent to law firms is a special exception for regular compensation that an unrelated taxable organization (e.g. a law firm) continues to pay its own employee while the employee provides services without charge to the filing organization, but only if the unrelated organization does not treat the payments as a charitable contribution to the filing organization.²⁰

PRIVATE SECTOR REACTION TO PART VI

Most of the private sector reaction to the new Form 990 has focused on the governance questions in Part VI. This portion of the Form was developed by the IRS with considerable input from the nonprofit community, including the Panel on the Nonprofit Sector, convened by Independent Sector (an influential consortium of charities) at the request of the Senate Finance Committee.²¹ Despite the IRS’ considerable efforts to consult with affected filers, private sector critics, including the IRS’ own Advisory Committee on Tax-Exempt and Government Entities (ACT), continue to point out that the good governance initiative could have some unintended consequences. As noted above, the chief fear is the creation of

counter-productive uniformity. In ACT's words:

"The inclusion of the [governance] questions ... inherently (and intentionally) suggests that the IRS supports adoption of specific governance policies and practices. The danger then is that organizations will take the path of least resistance and adopt the policies and practices whether or not they are appropriate for them, or effective in their context."²²

Significantly, ACT also challenged one of the central assumptions underlying the massive Form 990 revision:

"[T]here is little or no empirical evidence to date that supports the efficacy of any specific governance practices by nonprofit organizations, much less compliance with the requirements for maintaining tax exemption."²³

PART VI: ENFORCEMENT CONSEQUENCES

The Exempt Organizations unit of the IRS (EO) has taken ACT's criticisms very seriously. As early as the fall of 2008, Commissioner Miller noted:

"We have been arguing that good governance is related to tax compliance, but others challenge and question whether such a relationship exists. It seems like a logical inference to us, but some want proof. We are going to collect evidence on this question during the exam process ... but to understand the correlation between good governance and good compliance, some kind of new post-exam checklist seems useful. Once we have introduced such a checklist and used it long enough to collect some good information, we plan to report publicly on what we find."²⁴

Significantly, EO's Fiscal Year 2009 Annual Report includes the empirical study described by Miller in its summary of new compliance initiatives, also describing the relevant metric as:

"a checklist to be used by agents in examinations of exempt organizations to determine

whether the organization's governance practices impacted the tax compliance issues identified in the examination and to educate organizations about possible governance considerations."²⁵

More recently, internal training materials posted by EO on the IRS website in July of 2009 mention the checklist as a "next step."²⁶

Pending issuance of the checklist and analysis of checklist results, the recently released EO governance training materials direct revenue agents to avoid heavy-handed enforcement of perceived governance norms. An introductory PowerPoint slide, for example, notes (in very large, 20 point type) that

"When it comes to nonprofit governance, one size does not fit all."²⁷

Another slide cautions:

"There is no right answer to the question 'how many members should a board have?'"²⁸

A third slide advises:

"Practices will vary based on size, culture and type of organization, but each organization should consider the process that is best suited to its needs."²⁹

In this observer's opinion, these statements should not be interpreted as encouraging nonprofits to ignore governance issues. Practitioners should also remember that at least some recent research in the for-profit arena concludes there is indeed a link between good governance on the one hand and tax compliance on the other.³⁰ In my view, this is a battle that the IRS is not likely to lose.

Practical Tip #7: *Recognize the need for nonprofit board members and staff to develop customized policies and procedures that truly reflect each organization's culture and operational framework.*

Practical Tip #8: *Expect every future nonprofit audit to include a governance component and be ready to use the EO training materials to defend against a simplistic approach.*

IMPLICATIONS FOR GRANT MAKERS

In this new environment, grant making organizations need to become familiar with the new Form (including the Instructions) and to thoughtfully consider how the wealth of information it provides can best be used in the grant making process. They should also be aware of – and utilize – the expanded information likely to be made available on their grantees’ websites, including policies, procedures and financial information. As they do so, however, they would do well, in my view, to remember the mantra of the IRS training materials: one size does not fit all.

Practical Tip #9: *Grant making organizations that are not themselves Form 990 filers should be aware of the expanded information made available by the new Form.*

IMPLICATIONS FOR PRIVATE FOUNDATIONS

Given the massive changes in the Form 990, are similar changes in the works for Form 990-PF? With respect to family foundations, at least, the Form 990’s new emphasis on the independence of board members is, in my view, unlikely to migrate to Form 990-PF. On the other hand, a carefully tailored conflict of interest policy would appear to be de rigueur for any nonprofit, including private foundations. In addition, it is not inconceivable that a revised Form 990-PF would incorporate questions from the 990’s Part VII and/or Schedule J. We might expect, for example, questions about compensation of officers, directors and key employees, including the maintenance of written compensation policies

that take into account salary comparables. Similarly, private foundations should be sure they have written reimbursement policies. If you are unsure where to start, look at the questions posed on Schedule J (Part 1, line 1a) about expenditures for first-class travel, club dues and travel for companions. Another sensitive area is “severance payments” for former board members. In the private foundation context, where family and charity are so closely intertwined, everyone must work just a little harder to ensure all expenditures are consistent with charitable purpose and do not endanger the entity’s tax-exempt status.

Practical Tip #10: *If you advise private foundations, anticipate the eventual migration of governance and compensation questions from Form 990 to Form 990-PF.*

CONCLUSION

The new Form 990 is not endearing – it is infuriatingly complex and can be inexcusably burdensome. At the same time, the pages of definitions, detailed instructions and charts have a number of worthy goals. First, they are designed to create uniformity in reporting, which in turn should make it easier to compare one entity with another. These comparisons, if carefully made, should prove useful not only for the IRS but also for grant makers and, ultimately, for the organizations themselves. Second, the detailed governance questions should encourage each reporting entity to review and evaluate the processes implemented by its governing board. Ideally, such enhanced self-awareness will lead to a renewed dedication to high standards. Finally, even the

ANATOMY OF THE REVISED FORM 990

Core Form, 16 pages

Schedule A: Public Charity Status, 4 pages

Schedule B: Contributors, 8 pages

Schedule C: Political Activities, 4 pages

Schedule D: Supplemental Financial Statements, 5 pages

Schedule E: Schools, 1 page

Schedule F: Activities Outside the U.S., 4 pages

Schedule G: Fundraising or Gaming, 3 pages

Schedule H: Hospitals, 4 pages

Schedule I: Grants in the U.S., 2 pages

Schedule J: Compensation, 3 pages

Schedule K: Tax-Exempt Bonds, 2 pages

Schedule L: Transactions with Interested Persons, 1 page

Schedule M: Non-Cash Contributions, 2 pages

Schedule N: Disposition of Assets, 3 pages

Schedule O: Supplemental Information, 2 pages

Schedule R: Related Organization and Unrelated Partnerships, 4 pages

comprehensive nature of the Form, with new questions on everything from unrelated business income (Core, Part I, line 7) to employment tax reporting (Core, Part V, lines 1 and 2) is arguably beneficial. If an 11-page Core and 16 Schedules help organizations identify potentially troublesome issues before they become unmanageable, the new Form 990 will have fulfilled an admirable mission. For these reasons, it seems fair to conclude that the true future impact of the Form 990 will depend in large part on how thoughtfully it is received by tax-exempts, their boards and those that advise them.

FOOTNOTES

1. "Form 990 Statistical Tables for 2006," irs.gov/taxstats/charitablestats/article/0,,id=97176,00html#2.
2. See, e.g. Miller, Steven T., "Remarks," Western Conference on Tax Exempt Organizations, Loyola University, 28, November 2008, irs.gov/charities/article/0,,id=200617,00.html.
3. "More Exempt Organizations Expected to File Form 990-EZ Following Changes, Shultz Says," 177 Daily Tax Report G-10, G-11, 2008.
4. "Uncertainties on Key Form 990 Issues Remain as Exempts Prepare for Deadline," 91 Daily Tax Report G-2, 2009.
5. *Ibid.*
6. 2008 Instructions for Form 990, 5, 2008.
7. Miller, "Remarks," 4.
8. *Infra*, "Private Sector Reaction to Part VI."
9. Instructions, 16, 2008.
10. *Ibid.*, 17.
11. *Ibid.*, 18, 19.
12. Miller, "Remarks," 8.
13. Instructions, 25 - 27, 2008.
14. IRS, Background Paper, "Form 990, Moving From the Old to the New," 15, 2008, irs.gov/charities/article/0,,id=181089,00.html.
15. Instructions, 50.
16. *Ibid.*, 49, 23.
17. *Ibid.*, 43, 53.
18. *Ibid.*, 23 - 24.
19. IRS, Background Paper, 19.
20. Instructions, 28.
21. Panel on the Nonprofit Sector, "Principles for Good Governance and Ethical Practice, A Guide for Charities and Foundations," 2007, nonprofitpanel.org/report/index.html.
22. Advisory Committee on Tax Exempt and Government Entities (ACT), "The Appropriate Role of the Internal Revenue Service With Respect to Tax-Exempt Organization Good Governance Issues," 3, irs.gov/pub/irs-tege/tege_act_rpt8.pdf.
23. ACT, 15.
24. Miller, "Remarks," 7.
25. The Exempt Organizations unit of the IRS (EO), FY 2009 Annual Report, 20, 2008, irs.gov/pub/irs-tege/finalannualrptworkplan11_25_08.pdf.
26. EO, "EO Determinations CPE-GOVERNANCE," 29, 2009, irs.gov/pub/irs-tege/eo_determ_gov_cpe_ppt.pdf.
27. EO, "Governance and Tax-Exempt Organizations, 2009 CPE Training," 4, 2009, irs.gov/pub/irs-tege/governance_training_presentation.pdf.
28. *Ibid.*, 38.
29. *Ibid.*, 50.
30. OECD Forum on Tax Administration, "Information Note, General Administrative Principles: Corporate governance and tax risk management", 2009.

© 2009, Northern Trust Corporation

Legal, Investment and Tax Notice: This information is not intended to be and should not be treated as legal advice, investment advice or tax advice. Readers, including professionals, should under no circumstances rely upon this information as a substitute for their own research or for obtaining specific legal or tax advice from their own counsel.

IRS CIRCULAR 230 NOTICE: To the extent that this message or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. For more information about this notice, see <http://www.northerntrust.com/circular230>.

northerntrust.com



Northern Trust