

The 2008 Form 990:
Putting Your Best Foot Forward under Heightened Scrutiny

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The IRS retains the names of more than 1.3 million nonprofit entities in its master files. In 2004, the most recent year for which data is available, the IRS received 364,601 Forms 990 and 142,269 Forms 990-EZ. And yet, the Form 990 — the principal channel of communication between nonprofit organizations and the federal government — had not been revised in any significant way for nearly 30 years.

After months of deliberation and public comment, guided by the principles of “transparency, compliance, and burden minimization,” the IRS has released the long-awaited final draft of the 2008 Form 990. The 2008 Form 990 replaces the current 9-page form and its 2 schedules with an 11-page “Core Form” with 16 schedules. In addition, the IRS has stated that it will release instructions to the new form in early 2008. The new form will apply and need to be used for the 2008 fiscal year (fiscal years that begin in 2008), so organizations that operate on a calendar year fiscal year will be required to file the new form by May 15, 2009, while those with non-calendar year fiscal years will not need to utilize it until some time after that.

In the redesigned form, the IRS requests significantly more information than in previous years. However, the 2008 Form 990 also allows tax-exempt organizations to better describe their activities and contributions to the community. The organizations best prepared to take advantage of this opportunity — and least likely to be lost in the transition to the remodeled form — will be those that educate themselves on the new reporting requirements, implement policies and procedures that respond to those requirements, and plan to track information never before required by the IRS.

Core Form. Every organization filing a Form 990 must complete the 11-page Core Form, which has been radically redesigned for use in 2008. Filers will find a summary of key information on the very first page, designed to capture a snapshot of the organization’s basic financial, governance and operational structure. The IRS also has moved the “Statement of Program Service Accomplishments” up to the second page of the form, allowing the filing organization to explain *what* it does before accounting for *how* it does it.

In Part VI, a new section entitled, “Statements Regarding Governance, Management, and Financial Reporting,” a tax-exempt organization must now describe the composition of its board of directors, its governance and management structure, and its policies for promoting transparency and accountability to members and beneficiaries. For example, Part VI asks filing organizations how many voting board members it has, how many are independent, and whether any of the directors or officers have family or business relationships with one another or with key employees. Also notable in this

section is a new question regarding local chapters. If an organization has local chapters, branches or affiliates, it must report whether it has written policies and procedures in place to ensure that the chapters are operated in a manner consistent with the filing organization's tax-exempt purpose. Notwithstanding these requirements, the IRS has clarified that no particular policy or form of governance is compelled as a matter of law, and encourages organizations to fully explain and provide the context for their preferred method of administration.

Part VII, regarding "Compensation of Officers, Directors, Trustees, Key Employees, and Five Highest Compensated Employees," has changed in more subtle ways. All tax-exempt entities — not simply 501(c)(3) organizations — are now required to report the five highest employee salaries. The threshold for that reporting requirement has been raised from \$50,000 to \$100,000. When accounting for executive compensation, filers will now use Form W-2 and Form 1099 information as a starting point, but must also provide an *estimate* of nontaxable fringe benefits (such as retirement plan contributions and health and welfare benefits) in order to allow for a more complete picture of the compensation package. See the "Executive Compensation" section below for more on the reporting of executive compensation in Schedule J.

One of the most popular and least complicated additions to the 2008 form is Part IV, "Checklist of Required Schedules," designed to provide the IRS with a broad overview of an organization's activities and to assist organizations with completing the proper sections. By answering this series of questions, a tax-exempt organization verifies which of the 16 Form 990 schedules it is required to submit. The IRS has revised many of the old schedules and added new schedules to the list. The total effect will require organizations to track and disclose certain information with much more detail than in the past.

Public Charity Status and Public Support. Prior to the release of the 2008 form, Schedule A — which must be completed by all 501(c)(3) public charities — required information regarding numerous topics unrelated to the basis of the organization's public charity status, such as information about lobbying activities and transactions with non-charitable tax-exempt organizations. The redesigned Schedule A now focuses exclusively on public charity status; the questions on unrelated topics have been moved to other schedules. In addition, the public support test testing period has been increased from four to five years (to simplify the process and allow for the eventual elimination of the advance ruling process), the public support test for 509(a)(1) organizations has been separated from the support test for 509(a)(2) organizations, and space has been added for a narrative explanation to justify the "10% facts and circumstances" test, if applicable.

Political Campaign and Lobbying Activities. Since Form 990 was first drafted nearly thirty years ago, tax-exempt organizations have grown more and more adept at participation in lobbying and political activities. The redesigned form incorporates expanded questions about lobbying and political expenditures and activities into a new Schedule C. Of note, the IRS has added questions regarding the transfer of funds between tax-exempt organizations and so-called "527 organizations," and non-501(c)(3)

tax-exempt entities will now be required to provide more extensive reporting of lobbying and political campaign activities.

Statement of Activities Outside of the United States. In order to provide a more complete picture of an organization's international activities, Schedule F now requests information about tax-exempt organizations that raise funds, make grants, or conduct trade, business or other activities outside of the United States. Organizations with more than \$10,000 of aggregate expenses or revenues from foreign activities will be required to describe their operations on a region-by-region basis, and to provide information regarding grants or assistance made to foreign governments, organizations and individuals. These reporting requirements are expected to result in new recordkeeping practices for entities with substantial overseas activities.

Executive Compensation. Nonprofit officers, directors and employees who earn more than \$150,000 in reportable compensation (as reflected on Forms W-2 or 1099) or \$250,000 in total compensation (including nontaxable fringe benefits and expense reimbursements) will trigger more detailed reporting requirements in a redesigned Schedule J, including breaking out base compensation, bonus and incentive compensation, other compensation, deferred compensation, certain nontaxable benefits (described below), and compensation reported in prior Forms 990. While the final version of Schedule J eliminates the reporting of *de minimis* fringe benefit and nontaxable expense arrangement/reimbursement amounts that had been included in the draft, certain arrangements that may raise "tax compliance and transparency concerns" must now be reported, including payments for first-class or charter travel, travel for companions, tax indemnification and gross-up payments, discretionary spending accounts, housing allowances and payments for the business use of a personal residence, health or social club dues or fees, and personal services (such as those of a maid, chauffeur or chef).

The double counting of deferred compensation — requiring deferred compensation to be reported both in the year earned and the year paid — has been controversial, as it can lead to a perception that an individual's compensation (in a single year and on a cumulative basis) is greater than it actually was. While the IRS believes that such double reporting is necessary for "transparency and compliance reasons" and is not eliminating this requirement, a new column was added to the final Schedule J to report amounts that also were reported in a prior year.

Transactions with Interested Persons. The old form required disclosure of transactions between the organization and its "insiders," including excess benefit transactions, grants and other business arrangements. Schedule L has been restructured to incorporate all such conflict-of-interest reporting in a single location.

Non-Cash Contributions. The old Form 990 failed to capture an accurate picture of the non-cash contributions received by exempt organizations, even when these contributions provided substantial benefit to the organization. The IRS added Schedule M to collect information about non-cash donations ranging from clothing and household

goods to intellectual property, real estate, and easements. Quantity reporting is not required for some contributions; an organization need only check a box to show that it has received clothing, appliances, books, or publications. When quantity reporting is required, it should be based on the number of contributions made, as opposed to the number of items contributed.

Supplemental Information. One of the most significant criticisms of the old form was its inability to depict the full scope and impact of an organization’s activities. The new Form 990 contains a new Schedule O, allowing electronic filers up to two pages to respond to each question on the form, and an additional two pages to present any other information it might want to include in the overall report.

Related Organizations and Unrelated Partnerships. The IRS added Schedule R to capture the increasingly complex organizational structure of many tax-exempt entities, and to improve transparency with respect to partnerships, limited liability companies, and other related organizations. The schedule is designed to add a new dimension of scrutiny in assessing an organization’s compliance with its tax-exempt purposes and, in the case of 501(c)(3) organizations, the potential for private inurement and private benefit (the ban on private inurement applies to other categories of tax-exempt organizations as well).

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With all of these changes now in effect, nonprofit organizations likely will want to focus most immediately on two distinct areas — the process for approving executive compensation and organizational governance.

Approval of Executive Compensation. Because the 2008 Form 990 requires organizations to disclose expanded details of compensation packages, substantiating the reasonableness of executive salaries and benefits must be a top priority. As every tax-exempt organization knows well, details reported in the Form 990 become public information. An organization that pays employees what may be viewed as excessive compensation risks affecting its public perception and jeopardizing future fundraising efforts, membership support, and the like.

While the Form 990 does not directly reference the “intermediate sanctions” rules applicable to 501(c)(3) and 501(c)(4) organizations, a question in the governance policies section of the new form does ask if “the process for determining compensation . . . include[s] a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision.” The Treasury Regulations set out the criteria necessary to create a “rebuttable presumption of reasonableness” of compensation received by officers, directors and employees. Tax-exempt organizations of all types that utilize the rebuttable presumption may find it helpful to defend against additional scrutiny from the IRS and the public in connection with their executive compensation. To qualify for the presumption, the Treasury Regulations provide that the following three requirements must be met:

- The organization’s governing body, or a committee of the governing body free of conflicts of interest with respect to the transaction, must approve the compensation arrangement;
- The governing body or its committee must have obtained and relied upon appropriate comparability/benchmarking data — such as industry surveys or compensation studies — prior to making its decision; and
- The governing body or its committee must adequately document the basis for its decision at the time it is made.

Organizational Governance. The 2008 Form 990 requires detailed disclosure of an organization’s leadership structure and its governance policies. Both the IRS and the general public will want to see that the boards of directors are able to make independent judgments and exercise an undivided loyalty to the organization. Nonprofit organizations should review their procedures for board member election and qualification to ensure, if possible, that the majority of the organization’s voting directors are independent. (Generally, independent directors are those who do not have relationships with the organization or related persons that could impair their ability to make independent judgments or compromise their loyalty to the organization.) An organization should be prepared to explain who its board members are, how the organization selects them, and why its process for choosing directors is sound.

In addition, nonprofit organizations should conduct a general review of existing governance policies and practices, and consider adopting additional policies or guidelines as needed. To help paint a favorable picture in the Form 990, organizations may wish to adopt policies and procedures that cover setting compensation, conflicts of interest, whistleblower protection, document retention and destruction, chapter governance, and participation in joint venture arrangements. All policies should be written and their application and enforcement should be well documented.

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In preparing for the new form, time is of the essence. Nonprofit organizations should take the time now to become familiar with the 2008 Form 990 and to review their relevant policies and procedures, as early efforts to understand the form’s requirements will allow organizations to shape the activities and information now that must be reported next year. The 2008 Form 990 prompts organizations to tell their stories in more scope and detail than ever before; those that tell their stories best will be those that become familiar with the document sooner and respond accordingly.

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