GET READY FOR THE REDESIGNED FORM 990!

The IRS has released advance copies of the redesigned Form 990 and the related instructions. For tax years beginning on or after January 1, 2008, the new Form 990 filed by most tax-exempt organizations will involve additional disclosures. Developing a game plan now and reviewing organization policies and procedures as soon as possible should make the process more efficient. A modified Form 990EZ will continue to be available to certain smaller organizations. In fact, special transition rules outlined below may allow many organizations with annual gross revenue of less than $1 million to file the 990EZ during a brief transition period. Private foundations will continue to file the Form 990PF. The Form 990PF was not redesigned but could contain changes for 2008.

Although the 2008 Form 990 and instructions are still marked “draft”, the IRS does not expect changes to what has been released other than corrections or additional explanations. The forms and instructions can be found on the IRS web site (www.irs.gov) under the “Charities and Non-Profits” tab. The new form consists of an 11 page “core form” and up to 17 standardized schedules (Schedule A, B, C …) to be attached, if applicable. For example, the revised Schedule A will apply to public charities and require information on public charity status. Other information on the old Schedule A has been moved to other schedules or the core form with some modifications. On the redesigned Form 990, the main financial information has been moved to the end of the core form. This is a sign that the IRS has a focus on more than the numbers – details regarding governance, operations and compliance with tax laws are a major part of the form. The instructions have become more technical and include a glossary of terms.

If the old form was equivalent to a multiple choice and fill-in-the-blank quiz, the new form is that plus an essay exam. In some sense, this is an internal audit of the organization’s compliance with federal tax rules. However, the resulting return is hardly an internal document as it is to be filed with the IRS and is available to the media and the public. What follows are selected highlights of significant changes to the form and new information to be gathered.

Mission and Program Services

The first line of the first section of the new Form 990 requires a brief description of the organization’s mission or most significant activities. There is also a new question on the total number of volunteers. While the final form does not require the calculation of financial ratios, the first section requires key, high-level numbers for the current year and prior year with the intent that page one will give an overall first impression of the organization.

The third section of the form is the “Statement of Program Service Accomplishments.” The main change here is that revenue derived directly from the activity must be reported in the same line item with the program service expenses. For this purpose, revenue does not include contributions received that are reported on line 1 of the “Statement of Revenues”, but it may encompass various kinds of exempt function income and certain unrelated business income. For example, a charity reports its three largest activities (by expenses incurred). If the first program reported is the operation of a clinic, the fees received from services rendered to clients would have to be reported in addition to information reported on the old form, i.e., a clear, concise, complete description of the program services and the related expenses. A new blank for the dollar value placed on donated services or use of property received in connection with a specific activity may, but is not required to be, completed. Previously, donated services could be reported in total rather than by activity. Organizations that are not exempt under sections 501(c)(3) or (4) still have the option of reporting only the descriptions of the programs and not reporting the related income and expenses related to the program service accomplishments.
Governance

Page 1 of the new form requires the total number of board members (or equivalent) and the number of independent voting board members. A three-part test is contained in the instructions which define independent voting member. If the board will not change significantly before the end of the year, this analysis could be done sooner rather than later. For organizations with smaller boards, this may be the time to consider whether to add additional independent directors.

The final instructions have also changed the definition of “business relationship” for purposes of determining whether disclosure of such relationships among board members and other key insiders is required.

There is a “reasonable effort” standard for determining independence and business relationships (above). The instructions suggest that one way to have made a reasonable effort is to distribute a questionnaire to officers, directors and key employees. The contents of the questionnaire are also specified in the instructions.

The form will request narratives detailing the implementation of a conflict of interest policy, if adopted, and record retention policies. There are also questions pertaining to contemporaneous records of meetings and governing body actions (including committees authorized to take actions on behalf of the governing body), whether there was a material diversion of assets, and how officer and key employee compensation is determined.

Last but not least, there is a question asking whether the Form 990 was provided to the organization’s governing body before it was filed as well as a question requiring a description of the process used to review the 990 before filing.

The IRS has stated that federal tax law does not require all of the governance procedures to be implemented by all organizations. However, if enough questions are answered “no”, one might expect the chances to be selected for an IRS audit to increase. The IRS leadership believes that organizations that properly implement such procedures and other best practices are more likely to have a good record of compliance with the tax rules. Furthermore, if a situation arises, for example, if a conflict of interest policy is not in place and the return fails to report a required disclosure of a related party transaction, the government may be more likely to impose penalties (or impose larger penalties) than if the “best practices” had been followed.

IRS Filings

The IRS has added a section to the core form, “Statements Regarding Other IRS Filings and Tax Compliance”. New questions in this section request the number of information reports filed such as Forms 1099 and W-2G. There is also a question as to whether backup withholding requirements were followed for reportable payments to vendors and reportable gaming (e.g., a raffle or Las Vegas night) prizes.

There are also questions about how many W-2’s were transmitted for employees and whether all required payroll returns were filed. Items have been added for automobile donations and sales of tangible personal property for which a Form 8283 was required to be filed by the donor and signed by the charity (certain works of art or other tangible property with a value over $5,000 subject to the requirements for the donor to obtain an appraisal).
Compensation

The required disclosures of compensation have been expanded for all types of Form 990 filers, and the information required has changed. Compensation of certain highest paid employees other than officers and key employees and compensation of certain highest paid independent contractors and other information will be required for all types of tax-exempt entities filing the new core Form 990 (Part VII.) The threshold for the highest paid has generally been increased to $100,000 from $50,000. Compensation is defined by reference to the amount reported on the W-2 or Form 1099 MISC. For Part VII and Schedule J (the listing of officers’ etc.) compensation will be determined on a calendar year basis even for fiscal year organizations. Officer and director compensation remains subject to disclosure regardless of whether it is over the threshold amount. The reporting of most compensation from related organizations is reported side by side with compensation of the entity filing the return. The IRS has revised the rules for determining compensation from related entities in response to structures used to avoid the old rules. There have also been changes in the reporting of former officers and key employees. In part, these changes consist of a minimum threshold before reporting is triggered and a look-back period of five years.

Compensation may need to be reported in more detail on Schedule J. The extra reporting may be triggered by any of three factors: 1) Payment to a former officer, director, key employee, or former highest compensated employee. 2) Payment of compensation in excess of $150,000 (including from related organizations) to a current officer, director, key employee or highest compensated employee, or 3) Compensation (salary, grants or other payments) is paid by an unrelated organization to a person acting in their capacity as an officer, director or employee of the filing organization for services rendered to the filing organization. (Rules and exceptions for this third factor are discussed in detail in the instructions.) On Schedule J, a breakdown of base salary, bonuses and other pay will be required along with information on the individual’s fringe benefits.

For purposes of Part IX “Statement of Functional Expenses” in the core form, salary expense will continue to be on the fiscal year basis using amounts based on the method of accounting for book purposes. Compensation paid by related entities reported in Part VII and Schedule J (discussed above) is not included in Part IX. On this statement, salary and fringes are combined to arrive at the amount for the line entitled “compensation of current officers, directors and key employees.” Thus, officer, director and key employee compensation and benefits appear on a single line; and the benefit expense lines in the Form 990 “Statement of Functional Expenses” will only include fringe benefit expenses for the rank and file employees. The instructions clarify that compensation for board members who are not paid for serving on the board but are paid for other services (e.g., a special consulting project) is reportable as compensation of directors.

A key employee is generally redefined as one paid more than $150,000 of reportable compensation, has certain management authority or responsibility over the organization or a segment of the organization that comprises 10% of the organization (measured by assets, or expenses or revenue) and is one of the top 20 employees meeting the other criteria.

There is also a new series of questions on compensation. This may require disclosure of the specific types (but not necessarily amounts) of benefits provided including first-class travel, travel for spouses and club dues. For 501(c)(3) and (4) organizations, there are new questions on whether any compensation is contingent on revenues or other non-fixed payments.
Assets and Liabilities

Schedule D, one of the new schedules, requires certain additional financial information. There is a new section on donor advised funds, art and similar assets and endowments. While some items on this schedule mainly apply to 501(c)(3) organizations, there are sections that will have wider application. These include a summary of depreciable property, information on escrow and custodial arrangements, information on certain securities that are not publicly traded (e.g., financial derivatives or closely held equity interests) and disclosure of FIN 48 information included in a financial statement of an organization.

FIN 48 is a recent accounting standard for “uncertain tax positions” that is already effective for public companies. The FIN 48 effective date for non-public entities issuing GAAP financial statements, including such not-for-profit entities, was previously deferred to 2008. The accounting standard may require a footnote to the financial statements that explains the liability for state, federal or foreign income taxes. For example, the law may not be clear whether some activities (or portions of activities) generate unrelated business taxable income. Organizations may be required to analyze their tax exposure and conclude whether an income tax liability should be recognized under this standard. For single entity financial statements (not consolidated), the FIN 48 footnote must be provided verbatim in Schedule D of Form 990. Entities with consolidated statements will need to supply the information from the footnote that pertains to the entity filing the return. Although there are industry groups requesting a further deferral of the effective date of FIN 48, it is unclear whether any further deferral or exemption will be granted.

Fundraising and Gaming

Details on the methods used to raise funds and most payments to consultants/fundraisers will be reported on Schedule G (generally subject to a $15,000 threshold for each class of activity – fundraising consultants, special events, or gaming.) Details on the two largest fundraising events will be reported here similar to the three largest “special events” that were reportable as an attachment to the old form. Also, there is a new section on gaming activities that includes questions (who, what and where) as well as financial information on gross revenues, cash prizes and other direct expenses. Gaming includes activities such as raffles, gaming tickets, bingo, and casino nights.

Grants Over $5,000

A grant or other assistance provided to other organizations will be required to be reported if the aggregate amount exceeds $5,000 during the year (determined on a per recipient basis). When the $5,000 is exceeded, additional information will need to be collected: 1) the EIN of the grant recipient, 2) if the recipient is tax-exempt the Code section under which the recipient is exempt, 3) potentially, more detailed information on the ultimate use. Scholarships have been combined with other assistance payments to individuals in a separate section. Individual recipients are not identified but a specific description is required of the kinds of assistance provided.

Transactions with Interested Persons

“Interested persons” is a term used in the instructions that encompasses three groups. The first group is officers, directors, trustees, key employees, and the five highest compensated employees. The other two groups are specific to organizations described in sections 501(c)(3) or (4). This is based on the definition of “disqualified persons” for purposes of the intermediate sanctions on excess benefit transactions (persons with substantial influence and certain entities related thereto). Additional definitions apply to Section 509(a)(3) charities. There is a five-year look-back period which may apply. While some of the terminology is very technical, it is important that organizations identify these insiders and maintain documentation of transactions with such persons (both
the amounts and the approval process). A new schedule will require detailed information on loans to or from interested persons, grants or assistance benefiting interested persons and also certain business transactions with such persons. This replaces questions on the old Schedule A by using the terminology currently in the tax law and provides a more structured format for disclosing the payments or transactions. All 990 filers will need to complete this schedule if the transactions in question have occurred during the year.

**Non-Cash Contributions**

If in the aggregate the value of non-cash donations exceeds $25,000, a new schedule is to be completed. The new schedule lists 24 types of non-cash contributions (from art to taxidermy) with additional lines for “other”. For each type of property received, an organization is required to state the number of contributions, the revenue reported on the core form as contributions, and the method for determining the amount of revenue. Among the questions posed on this schedule is one that requires the number of “Donee Acknowledgements” of Form 8283 completed (signed) by the organization (certain gifts over $5,000 subject to requirements that the donor obtain an appraisal). Another question asks if property was received that is going to be held for three years but is not required to be used for exempt purposes. The use of the property may affect the amount of the donor’s deduction and may trigger a requirement to communicate to the donor how the property is used.

**Tax Exempt Bonds**

A separate schedule is required for organizations that use the proceeds of a tax-exempt bond issue to finance property. For 2008, only Part I of this schedule is required to be completed. However, the IRS has been actively checking exempt organizations’ compliance with record keeping and observance of the terms of the bonds. So, even though the entire schedule will not be required, the organization is still responsible for compliance with all of the rules. There is an exception to completing this schedule for bond issues occurring before 2003.

**Hospitals**

For 2008, only Part V (Facility Information) will be required. Beginning in 2009, the entire schedule will be required which includes questions on charity care and certain other community benefits at cost, bad debts, Medicare and collection practices, and management companies and joint ventures.

**Related Organizations**

Much of this schedule is a reformatting of information requested on the prior version of Form 990’s. “Related” generally refers to a greater than 50% ownership or control. This schedule may apply to all types of 990 filers. There is some additional information needed such as legal domicile, whether there are disproportionate partnership allocations, and the Unrelated Business Income reported on Form K-1 by a partnership. The last section of the Schedule requires new information pertaining to partnerships where the ownership is less than required to be related (generally 50%) but more than 5% of the filing organization’s activities were conducted through the partnership.
Phase In

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The new Form 990 series returns will be effective for 2008 tax years (returns filed beginning in 2009). To allow organizations time to adjust to the new forms, the IRS is phasing in the new returns during a three-year transition period. During the transition, an organization’s annual filing requirement will depend on its financial activity. The charts below indicate annual exempt organization filing requirements during the transition period.

For all years above, sponsoring organizations of donor-advised funds and controlling organizations described in section 512(b)(13) must file Form 990 regardless of the amount of their gross receipts or assets.

Conclusion

The new Form 990 remains a single form that applies to various kinds of exempt organizations such as charities, social clubs, and trade associations. While not every part or schedule will apply to each kind of organization, it is almost certain that all organizations will be reporting more information.

Penalties for an incomplete return or an incorrect return are the same as for late filing – up to $100 per day. While initially the IRS may be flexible, at some point more of these penalties may be assessed. If for no other reason, the use of standardized schedules (Schedule A etc.) will make it easier for the IRS to detect incomplete returns.
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There is still time in 2008 to develop policies and procedures. Also, it should be determined who has the data that will be needed for the various parts of the return and whether data is being collected in a form that will lend itself to efficiently completing the return.

We anticipate making templates or other aids available to our clients later this year to assist in the data collection for the return. Please contact us if you would like to schedule a meeting on how these changes will specifically apply to your organization.

P.S. A note on Form 990N: Beginning in 2008, organizations with less than $25,000 of gross receipts were generally required to file the 990N electronic postcard. The usual exception for certain church related entities and certain other groups continues to apply. As of July 27, 2008, the IRS had only processed approximately 140,000 of these returns. For organizations with a calendar tax year, the form should have been filed by May 15, 2008. There is no penalty for tardy filing of the 2007 Form 990N. Loss of exempt status is mandated by the tax law if either the required Form 990N or another variation of the series Form 990 is not filed for three consecutive years.

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