

Thursday, December 18, 2008

## Nonprofit Update: The New Form 990: Focus on Governance and Policies

By Laura A. LoBianco, Ellis M. Carter and Kendis Key Muscheid

As the 2008 calendar year ends, many tax-exempt organizations (TEOs) are closing their fiscal years and preparing for the completion and filing of Internal Revenue Service (IRS) Form 990, Return of Organizations Exempt from Tax. The IRS completed its first major redesign of Form 990 since 1979 and many TEOs will be required to file this new version in the coming months.

### Transition Schedule

The revised Form 990 is generally in effect for tax years beginning in 2008, to be filed in 2009. In order to alleviate the administrative burden on smaller TEOs, TEOs with annual receipts and total assets under certain threshold amounts may file Form 990-EZ as follows:

| <u>Tax Year</u> | <u>Annual Receipts</u>  | <u>Total Assets</u> | <u>Form</u> |
|-----------------|-------------------------|---------------------|-------------|
| 2008            | \$25,000 to \$1,000,000 | < \$2.5 million     | 990-EZ      |
| 2009            | \$25,000 to \$500,000   | < \$1.25 million    | 990-EZ      |
| 2010            | \$50,000 and \$200,000  | < \$500,000         | 990-EZ      |

TEOs with gross receipts below \$25,000 in 2008 and 2009, or below \$50,000 in 2010 and thereafter, may file Form 990-N, the "e-postcard" filing. TEOs that do not qualify for Form 990-N or Form 990-EZ will need to file the revised Form 990. There are no changes for TEOs previously exempt from filing any information return.

### IRS Interest in Governance

The IRS is focusing more on how TEOs are governed. Neither the Internal Revenue Code nor Treasury Regulations provide the IRS with direct authority over governance, structures and policies of TEOs. Nevertheless, IRS officials have rationalized the IRS' involvement in governance by proclaiming that "[t]he IRS believes that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance."

The IRS has published its own draft list of Good Governance Practices for TEOs, which has formed the development of numerous governance related questions in the revised Form 990. In the revised Form 990, the IRS requires each filer to disclose certain governance information such as the composition of its governing body, the existence and content of certain policies and procedures, and whether (and if so, how) the TEO promotes transparency and accountability to its donors and beneficiaries. Unfavorable responses to many of these new governance questions may leave an unfavorable impression with the IRS, potential donors and grantmakers reviewing the Form 990.

### quick links

- [Nonprofit Practice](#)
- [Unsubscribe](#)
- [Acrobat Reader](#)

Phoenix  
3003 N. Central Ave.  
Suite 2600  
Phoenix, AZ 85012  
(602) 916-5000

Tucson  
One S. Church Ave.  
Suite 1000  
Tucson, AZ 85701  
(520) 879-6800

Nogales  
420 W. Mariposa Rd.  
Suite 200  
Nogales, AZ 85621  
(520) 281-3480

Las Vegas  
300 S. Fourth St.  
Suite 1400  
Las Vegas, NV 89101  
(702) 692-8000

Denver  
1700 Lincoln St.  
Suite 2900  
Denver, CO 80203  
(303) 291-3200

Further, the IRS may use information gleaned from filings of the revised Form 990 to begin compliance check projects. “Compliance checks” are a relatively new compliance tool the IRS has been using to promote tax compliance among exempt TEOs, in place of more costly audits. Unanswered and in-artfully answered IRS Compliance Check letters can, and often do, develop into single or multiple issue audits. All TEOs that receive compliance check letters should take care in responding and should seek advice on responses from their tax advisors.

## Prepare Your Organization For Future Filings

Organizations that do not have the option of filing the Form 990-EZ or Form 990-N are recommended to implement the practices, policies and procedures that may be required to provide favorable responses to many of the new governance and policy oriented questions on the revised Form 990.

## Governance, Policy and Procedure Related Questions

Governance, policy and procedure related questions are sprinkled throughout the revised Form 990; however, several key governance questions are concentrated in Part VI. For example, TEOs must now disclose the following governance and procedure information:

- the number of voting members of its governing body and how many voting members are independent (e.g. are not compensated as an officer or employee of the TEO or related organization);
- family or business relationships among its officers, directors, trustees, and key employees;
- whether the TEO has delegated management duties to a management company or other third-party;
- if the TEO has members, whether the members or other persons have the right to elect the governing body and whether any of the governing body’s decisions are subject to member or third-party approval;
- whether the TEO contemporaneously documents the meetings of its governing body; and
- the process, if any, of the members of its governing body in reviewing the Form 990 before it is submitted.

The revised Form 990 also requires the TEO to identify whether it has adopted the following written policies:

- Conflict of Interest Policy and Annual Disclosures. We strongly recommend that all TEOs implement a conflict of interest policy and annual disclosure form that covers the TEO’s officers, directors and key employees, with procedures that comply with state law and reflect the process required to meet the “rebuttable presumption” of reasonableness under the intermediate sanctions rules and captures the information required to be disclosed on the revised Form 990.
- Whistleblower Policy. Not only is adoption of a written a whistleblower policy recommend for disclosure on the revised Form 990, but such a policy also provides the TEO with the process (when followed) to avoid potential criminal liability under the Sarbanes-Oxley Act. (Some organizations have these policies contained in their employee handbook.)
- Document Retention and Destruction Policy. Like the whistleblower policy, a document retention and destruction policy addresses both the IRS revised Form 990 and potential liability under the Sarbanes-Oxley Act.
- Compensation Policy. The revised Form 990 requires TEOs to describe the procedures the TEO uses to establish compensation for its officers and key employees. Accordingly, we recommend that TEO’s who have paid executive staff implement a compensation policy that includes review and approval by independent persons, considers comparability data, and in which the deliberation and decision-making processes are contemporaneously documented.

- **Expense Reimbursement Policy.** In recent years, the IRS has subjected expense reimbursements to extra scrutiny. Even if a TEO does not reimburse for the types of luxury expenses enumerated on revised Form 990, it should consider implementing a general expense reimbursement policy.
- **Investment Policy.** An investment policy provides the guidelines by which the funds of the TEO will be invested and serves as the instructions to the investment committee, finance committee or investment advisor regarding investment goals and risk tolerance when investment decisions are to be made.
- **Gift Acceptance Policy.** A gift acceptance policy addresses how the TEO will review and handle any non-standard contribution, such as gifts of real property, art or collectibles, or interests in a closely held business.

For TEOs that conduct certain activities, the revised Form 990 inquires about the adoption by the TEO of additional policies and procedures governing the following matters:

- Conservation Easements
- Policies for Hospitals
- Policies for Tax-Exempt Bond Issuers
- U.S. Grant Procedures
- Foreign Grant Procedures
- Policies Governing Chapters, Affiliates, and Branches
- Joint Venture Policy

The IRS strongly believes that the existence of an independent governing body and strong internal governance policies and procedures increases the probability that the TEO is complying with federal tax law. While there is no legal requirement that a TEO adopt these policies, TEOs that report that they do not have them may be more likely to be subjected to an audit or compliance check.

## CONCLUSION

TEOs should review their existing practices, policies and procedures. Those TEOs that wish to be in the best position to provide favorable responses to the governance, policy and procedure questions on the revised Form 990 should take action.

*Laura A. LoBianco focuses her practice on corporate law and transactional matters. Her general corporate experience includes business counseling, formation of organizations, including non-profit, tax-exempt organizations and limited liability companies; corporate governance and maintenance of requisite organizational records. She advises various tax-exempt entities, such as private foundations, support organizations, public charities and other entities that are tax-exempt under the Internal Revenue Code. She received her B.S. (1993) from Arizona State University and her J.D. (1996) from Santa Clara University, School of Law.*

*Ellis M. Carter focuses her practice on advising tax-exempt and non-profit organizations with respect to corporate, tax and regulatory issues. She represents non-profit organizations in matters such as qualification for tax exemption, conversions to and from tax-exempt status, mergers and restructuring, joint ventures and entrepreneurial activities, maintaining or obtaining favorable tax-treatment, creation of supporting organizations, unrelated business income tax, advocacy issues, charitable solicitations, endowment management, governance issues, compensation matters, intermediate sanctions, and tax-exempt bond financing. She received her B.A. (1993) from Northeastern University, her J.D. (1996) from Seattle University and her LL.M (1998) from the University of Washington.*

*Kendis Key Muscheid practices primarily in the areas of nonprofit and tax-exempt organizations, charitable trusts, and state and local taxation. She also advises entities that are tax-exempt under a number of other Internal Revenue Code sections. Ms. Muscheid represents non-profit organizations in a wide assortment of matters such as qualification for tax exemption, conversions of entities to and from tax-exempt status, obtaining and maintaining favorable tax-treatment, reporting and government filings, the creation and operation of supporting organizations, private foundations and public charities, unrelated business income tax, advocacy issues, charitable solicitations, endowment management, tax-exempt bond financing, mergers, governance issues, compensation matters, and intermediate sanctions issues. She received her B.B.A. (1986) from Texas Tech University and her J.D. (1991) from the University of the Pacific McGeorge School of Law.*



Laura A. LoBianco  
Director  
(602) 916-5345  
llobianco@fclaw.com



Ellis M. Carter  
Director  
(602) 916-5493  
ecarter@fclaw.com



Kendis Key Muscheid  
Director  
602.916.5354  
kmuscheid@fclaw.com