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Revised 990 Form Calls for Tools for Good Governance

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Beginning with the 2009 tax reporting year, exempt organizations must provide significantly greater information on the manner in which they operate, manage their funds, compensate top officials, and allocate their resources to exempt activities. As Sarah Hall Ingram, the IRS' Commissioner of Tax Exempt and Governmental Entities said recently "the rubric of 'good governance' is the development by each organization of a system of internal controls that is appropriate to the organization itself . . . to minimize the risk of events occurring that contravene the Code's requirements for tax exemption."

The IRS will obtain this information beginning this year on the Form 990 which was revised in December, 2008. Organizations that must report such information on the 990 (or 990-EZ) are those exempt from income tax under Internal Revenue Code section 501(a) (organizations exempt under sections 501(c), 501(e), 501(f), 501(k), 501(n), and 4947(a)(1)). Virginia and North Carolina non-profit and tax exempt lawyers know that the information requested on this form can indicate whether an organization has in place tools for good governance.

For years the IRS Commissioner has signaled that good governance is the lynchpin to compliance with the tax laws. As Ms. Ingram said "[f]or each instance of non-compliance found - excessive compensation, political intervention, inurement, private benefit, material diversion of assets - the agent should ask who made the decision to do it or to allow it [and] was their a policy in place . . . and if so, was it followed?" To help organizations prepare for the new 990, IRS developed a checklist which is very useful overview of what policies and practices should be adopted (www.irs.gov/pub/irs-pdf/p4740.pdf).

Part VII on the 990 requests information on the compensation, benefits, and loans made to current and former officers, directors, trustees, key employees, five highest compensated employees, and independent contractors. Direct, indirect, deferred compensation, compensation received from related entities (e.g. 501(c)(4) that is related to the 501(c)(3)), loans, incentive pay, bonuses, future severance payments, expense reimbursements, and other compensation must be reported. The focus of these questions is to expose inurement or private benefit to individuals.

Part VI on the 990 asks a series of questions relating to the governing policies and practices of the organization. Among these questions is whether the organization has established a compensation policy. A compensation policy is not required, but if one has been adopted, and followed, the tax code provides a "rebuttable presumption" that the compensation received was reasonable (a compensation checklist is found at www.irs.gov/pub/irs-utl/m4958a2.pdf). Three criteria must be met in order to create a rebuttable presumption: (1) compensation studies; (2) board approval; and (3) documentation to support basis for the compensation, including a compensation policy. If the compensation was not reasonable, two actions will result: intermediate sanctions (tax penalties) will be imposed against those receiving such compensation as well the potential for the organization to loose its exempt status.

To help an organization prepare for the 28 questions asked in Part VI, the IRS recently published a guidance document, "Governance and Related Topics - 501(c)(3) Organizations" (www.irs.gov/pub/irs-tege/governance_practices.pdf). The guidelines discuss the need for the following governance and management policies: (1) executive compensation; (2) conflicts of interest; (3) investments; (4) fundraising; (5) governing body minutes and records; (6) document retention and destruction; (7) ethics and whistleblower. Other topics discussed in the guidance are preparing of financial statements, the need for transparency and accountability, and the board duties of loyalty and care. IRS also modified the application form for tax exempt status to include provisions that relate to these policies.

One of the policies that the IRS encourages being adopted at the time of obtaining tax exempt status, or as soon as possible thereafter, is a conflict of interest policy. A sample conflict of interest policy may be found in Appendix A to the instructions for the Form 1023 (www.irs.gov/pub/irs-pdf/i1023.pdf). The IRS believes that a conflict of interest policy "is a means to establish procedures that will offer protection against charges of impropriety involving officers, directors, or trustees." Conflicts of interest frequently arise when setting compensation or benefits for officers, directors, or trustees. A conflict of interest policy is intended to help ensure that when actual or potential conflicts of interest arise, the organization has a process in place under which the affected individual will advise the governing body about all the relevant facts concerning the situation.

Other policies that are encouraged by the IRS include:

- Whistleblower
- Document retention and destruction
- Compensation review
- Expense reimbursement
- Procurement procedures
- Grant procedures
- Gift acceptance
- Tax exempt bond (record keeping and compliance procedures)
- Policies for hospitals on charitable care and bad debt
- Joint ventures
- Conservation easements (acceptance and monitoring)

"Good governance is a tool for managing the risk of non-compliance" said Ms. Ingram recently. "Where an applicant has a well-articulated mission, an engaged and independent board, and so forth, we have some basis for judging that this applicant will be more likely to carry out a tax-exempt purpose than a similar applicant without these safeguards."

As a result of these changes, transparency and accountability will play a greater role in the operations of exempt organizations. Not only will IRS be scrutinizing the 990s, but so will the public and donors. The 990's are public documents that can be viewed on web through organizations such as Guidestar.

If you have questions about policies that reduce risk and enhance good governance, the non-profit and tax exempt lawyers of Sands Anderson Marks & Miller can assist with answers and guidance. Contact Phyllis Katz or any of our other Virginia and North Carolina non-profit and tax exempt lawyers.