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Nonprofit Update: Draft Form 990 Represents Significant Reporting Changes for Non-Profits

By Ellis M. Carter

On June 14th, the Internal Revenue Service ("IRS") released a discussion draft of the redesigned Form 990, Return of Organization Exempt from Income Taxation. The IRS hopes to have the new version of the Form ready for the 2008 filing year (returns filed in 2009). Currently, the IRS does not have plans to significantly revise the Form 990-PF, the annual return filed by private foundations.

According to the IRS, the redesign is rooted in the following "guiding principles":

- enhanced transparency into exempt organizations -- for the IRS and the public;
- promoting compliance by accurately reflecting an organization's operations (to facilitate the IRS's ability to check for areas of noncompliance); and
- minimizing the filing burden on exempt organizations.

New Format

The redesigned Form consists of a 10-page core form to be completed by every exempt organization. In addition, there are 15 schedules aimed at requiring the reporting of information only from those organizations that conduct specific activities. Form 990 currently includes nine pages, two schedules, and 36 possible attachments.

Revised and Reorganized Core Form

The draft Form 990 reorganizes and consolidates several sections of the current Form 990 and introduces a number of new questions and schedules. Some of the highlights of the draft form are:

- Summary Section. All organizations must complete a new summary section that is prominently displayed on page 1 of the core Form 990. The summary section is designed to provide a snapshot of the key financial and operational information provided in the return and in the various required schedules. The summary includes new questions regarding board composition and board independence. The summary also highlights on page 1: (i) the number of individuals receiving compensation over \$100,000; (ii) the salary of the highest paid individual; and (iii) the aggregate salary of directors, officers, trustees and key employees expressed as a percentage of program service expenditures.
- Compensation. The core Form 990 has been re-designed to display key compensation information more prominently on page 2. The draft Form 990 consolidates

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and expands upon the compensation related questions that are currently included on Schedule A. The effect is to extend those questions to all exempt organizations, not just 501(c)(3) organizations.

New Schedules

- Executive Compensation. A new Schedule J demands detailed information regarding compensation of highly compensated and former officers, directors, trustees, key employees and highest compensated employees. Schedule J includes questions regarding compensation policies and procedures and requires a breakdown of compensation into 11 components. Schedule J highlights controversial compensation practices such as loans, equity based pay, retirement supplements and certain fringe benefits such as first class travel and club memberships.
- Political and Lobbying Activities. The lobbying questions currently included in Schedule A are consolidated into a new Schedule C, extending reporting of such activities to all exempt organizations, not just 501(c)(3) organizations. The schedule introduces new questions regarding exempt organizations' political activities and inter-corporate funds transfers.
- Additional Supplemental Financial Statement Detail. A new Schedule D consolidates a number of previously required attachments into one schedule and poses new questions related to financial statements. The draft Schedule D requires disclosure of financial statement footnotes related to uncertain tax positions and art collections. There are also new questions regarding conservation easements, donor advised funds and a five-year table highlighting the performance of endowment funds.
- Foreign Activities. A new Schedule F focuses on organizations engaging in international grant-making or conducting other activities outside of the United States. This schedule assists the I.R.S. in monitoring the potential flow of funds to terrorist organizations.
- Hospitals. A new Schedule H must be completed by organizations that operate a hospital or medical care facility (regardless of whether they check the "hospital" box). The schedule requires hospitals to report aggregate community benefit, including worksheets adapted from The Catholic Health Association's "A Guide for Planning and Reporting Community Benefit." The schedule requires information on hospital billings, collection practices, facilities, and joint ventures.
- Grants. A new Schedule I incorporates and expands upon existing questions regarding grants. Exempt organizations making grants in excess of \$5,000 annually will be required to disclose relationships among grantees and disqualified persons as well as provide details regarding grants to both organizations and individuals. This schedule is designed to increase transparency regarding grant-making and to make it easier for the IRS to identify grants that may amount to impermissible private inurement or private benefit.
- Tax-Exempt Bonds. A new Schedule K incorporates existing questions currently included in Part IV of the core Form 990. In addition, tax-exempt borrowers with bond issues of more than \$100,000 must report on the use and investment of bond proceeds as well as payments to outside advisers in connection with bond issuances. The IRS intends this schedule to highlight violations of record retention, private use, and arbitrage restrictions related to tax-exempt bond issuances. The schedule also provides information that will assist the IRS in identifying cases of impermissible private inurement, private benefit and excess benefit.

- **Loans.** A new Schedule L consolidates and expands upon loan related questions in the current Form 990 to include loans to and from highly compensated employees, and loans from other disqualified persons. This schedule will aid the IRS in identifying taxable compensation disguised as loan arrangements between exempt organizations and disqualified persons.
- **Non-cash Charitable Contributions.** A new Schedule M requires exempt organizations that receive more than \$5,000 of non-cash contributions to report the types of contributions as well as information regarding the donees' valuation methods.
- **Related Organizations.** A new Schedule R requires information regarding the flow of funds to and from controlled entities and non-charitable exempt organizations. Exempt organizations must provide information regarding all related organizations, including whether the related entities are disregarded, exempt, taxable partnerships, taxable corporations, or trusts. The IRS intends this schedule to improve transparency with regard to the increasingly complicated organizational structures of exempt organizations.

Comments Requested

The IRS has requested that comments on the draft form be submitted by September 14, 2007. The IRS has requested comments on specific issues, including:

- whether the IRS should preclude group returns (the draft Form 990 eliminates the group return information and group exemption number);
- whether the IRS should modify the reporting of community benefit by hospitals in Schedule H;
- whether the current filing thresholds should be raised for certain organizations (e.g., from \$25,000 to \$50,000);
- whether adequate care has been given to privacy concerns;
- additional items regarding governance and management best practices; and
- defining the relatedness for compensation and other purposes, including arrangements in joint ventures and with for-profit subsidiaries.

Fennemore Craig Analysis

The new questions and schedules provide additional transparency to donors and pinpoint potential problem areas for the IRS. The IRS maintains that most organizations will not experience a material change in their filing burden, although those with complicated compensation arrangements, related entity structures, and activities that raise compliance concerns, are certain to face a significant increase in the effort and resources required to complete the Form 990.

While the draft form may change significantly before it is finalized, we recommend that organizations required to file Form 990 review the draft form and carefully consider their responses. The IRS plans to have the revised form ready for 2008 returns filed in 2009. Organizations, therefore, have the remainder of 2007 to address any issues that might lead to a potentially embarrassing or risky response required by the new Form 990.

Copies of the draft Form 990 and related materials can be accessed on the IRS website at www.irs.gov. Interested parties are encouraged to provide comments regarding the draft Form 990 through September 14th. Comments may be submitted to the IRS at Form990Revision@irs.gov

Ellis M. Carter's practice focuses 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 earned her B.A., (1993) from Northeastern University, her J.D., (1996) from Seattle University and her L.L.M., (1998) from the University of Washington.