Early Planning Will Prevent Problems or Delays

New IRS Form 990 requires careful consideration and preparation

by Kathryn M. Vanden Berk

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With its first major redesign since 1979 completed, the new IRS Form 990 will be required for most nonprofits beginning with the filing of 2008 annual returns. Even though your filing date may still be several months away, you will be best served if you start planning for the new Form 990 today.

I suspect that most of you will be working with your accounting firms to capture the required financial information. The changes that I will address in this column concern compensation and certain governance policies and practices that are addressed for the first time in Form 990.

Evolution of Form 990

The first Form 990, issued in 1942, was only two pages long. After the recent redesign, today's Form 990 consists of an 11-page "core" form that must be completed by every filer, plus 16 schedules that are used for specific purposes. Yet, most practitioners are generally satisfied with its format since the new form was designed only after the IRS solicited comments from the public.

Nevertheless, the new form is tricky and many organizations will have trouble adapting to it. For that reason, the IRS is offering a phased plan for smaller organizations.[1]

Form 990 instructions are now available, but they are still in draft format, and there will be many questions still unanswered when returns are being prepared. I suggest you download a draft Form 990 from the IRS website.[2] As you look through its core form and schedules, you can quickly focus in on those areas where you might need to make changes now in preparation for reporting next year on 2008 activities.

Reporting Relationships and Compensation

The new form requires that you list compensation information for a variety of individuals:

- Each of your current officers, directors, trustees, and key employees, regardless of the amount of compensation paid, must be named on the core form.
- Your five highest-compensated employees (other than officers, directors, trustees, or key employees) must also be listed.[3]
- You must also list any former officers, key employees, or highest-compensated employees who received a total of more than $100,000 in reportable compensation during the reporting year for your organization and any related organization.
- You must list each of your five highest-compensated independent contractors, which are any contractors that received more than $100,000 in compensation.

For each individual named on the core form, you must identify the average hours worked per week for each one, the reportable compensation stated on that individual's compensation from your agency and any related organization, and the estimated amount of "other compensation" received from your agency and any related organization.[4]

Compensation to be reported is based on their most recently filed Forms W-2 and 1099 for the calendar year that ends during your reporting year. For example, if your fiscal year ends on May 31, 2009, you will report compensation for the entire calendar year of 2008.

You will also be required to describe your compensation policies and procedures. The IRS wants to know that your key employees' compensation is approved by independent persons, with appropriate comparability data, and that you prepare contemporaneous substantiation of your decisions.[5]

Governance Issues

The IRS is also looking for information about how your governance systems work. The IRS justifies its inquiries by explaining that they have found good governance usually results in compliance with IRS mandates. Here are some governance issues that the IRS will require you to disclose:

- the number of voting members of your governing body and how many voting members are independent of paid staff;
- family or business relationships between your officers, directors, trustees, and key employees;
- whether you have delegated control over management duties to a management company or other person;
- whether you contemporaneously document meetings of your governing body;
- whether members of your governing body have reviewed the Form 990 being submitted;
- whether you have a conflict-of-interest policy, a whistleblower policy, a compensation policy, or a document retention and destruction policy. (Sample conflict-of-interest, whistleblower, and document retention and destruction policies are available at alliance1.org/magazine.);
- if you have invested funds, whether you have an investment policy; and
- if you participated in a joint venture with a taxable entity during the year, and whether you have adopted a joint venture policy that will safeguard your exempt status.

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Again, many of these policies and practices are not required by the federal tax laws, but the IRS believes they indicate whether your organization has adequate internal controls. Thus, while there is no federal tax law requirement that you have many of these policies, an organization that reports it does not have them may find it is a more likely target for an audit.

Reporting Specific Organizations and Activities

Supporting Organizations. If you are supported by entities classified by the IRS as "supporting organizations," you will have a much more prominent role to play as their supported organization. Supporting organizations are required to support no more than five entities, and as electronic filing takes hold, the IRS will be better able to track the amount of support provided.

Tax-Exempt Bond Issuers. If you have any tax-exempt bonds, you will have to provide annual information about each tax-exempt bond issued after Dec. 31, 2002, with a principal balance of more than $100,000 outstanding. Information to be provided includes tracking bond proceeds and the use of the financed facilities.

When Steven Miller, IRS commissioner for tax exempt organizations, spoke to the annual Georgetown Law Conference on Exempt Organizations in April 2008, he noted that in 1998 there were some 650,000 section 501(c)(3) organizations. Today, there are 1.2 million. In 1998, the gross receipts of 501(c)(3) organizations were $990 billion. Receipts have more than doubled since then. He then stated, "What number has not changed over that time span? Our staffing."

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The IRS is using the Form 990 to create transparency in the system so that organizations that must be accountable to the public will have a tool for communicating what they do and how they do it. That is what the new Form 990 is intended to be. If you can prepare your agency now, your Form 990 return will cast your agency in a positive light and help you assure the public that you are a worthwhile partner in the care of children and families. ■

ENDNOTES

1. The phase in schedule is as follows: For 2008 returns, you are allowed to use the Form 990-EZ if your annual receipts are between $25,000 and $1,000,000 and your total assets are less than $2.5 million. For 2009 returns, you are allowed to use the Form 990-EZ if your annual receipts are between $25,000 and $50,000 and your total assets are less than $1.25 million. For 2010 and forward, you are allowed to use the Form 990-EZ if your annual receipts are between $50,000 and $200,000 and your total assets are less than $500,000. Organizations below these thresholds will file the new "e-postcard."
2. You may download a copy of the new Form 990 at irs.gov/pub/irs-tege/f990rcore.pdf. The IRS still presents it as a draft form, but it is not. This is the final form that will be used next year to report 2008 activities.
3. A "highest-compensated employee" is one who received a total of more than $100,000 in compensation.
4. Looking at other organizations' Form 990s is a popular place for many organizations to find comparable compensation information. By increasing the reporting floor from $50,000 in the current Form 990 to $100,000, it may be more difficult to find good comparables for smaller organizations.
5. You may find more information about how to deal with compensation issues at irs.gov/charities/charitable/article/0,,id=173697,00.html.

Kathryn Vanden Berk practiced law for nine years before serving as the president of two residential treatment centers for children. Now practicing in Chicago, she focuses on nonprofit start-ups, corporate and tax law, and employment issues. She serves as adjunct faculty at several Chicago universities, and is a member of the Advisory Board of the Axelson Center for Nonprofit Management at North Park University. She authored a handbook on starting nonprofits that is available from the Nonprofit Financial Center, Chicago, and a chapter in the Illinois attorney's handbook Not-for-Profit Corporations, *2004 Ed., Illinois Institute of Continuing Legal Education. In 2004 she authored* Retooling Employment Standards for the Future, *a publication of the First Nonprofit Educational Foundation, Chicago. She can be reached at 312-442-9076 or at info@beavandenberk.com.*