

Sugar Felsenthal Grais & Hammer LLP

30 N. LaSalle St., Ste. 3000
Chicago, Illinois 60602
Office: (312) 704-9400
Fax: (312) 372-7951

www.SugarFGH.com

NATIONAL BUSINESS INSTITUTE Tax Exempt Organizations from Start to Finish

FORM 990: KEY COMPLIANCE POINTS AND DISCLOSURE CONSIDERATIONS

Michelle Huhnke
Sugar Felsenthal Grais & Hammer LLP
30 North LaSalle Street, Suite 3000
Chicago, Illinois 60602
(312) 704-2779
mhuhnke@sugarfgh.com

According to the IRS's 2010 Annual Report and 2011 Work Plan, the "Form 990 is the IRS' primary tool to increase transparency and to promote and enforce compliance with Federal tax law. The recent design brings the Form 990 into the 21st century, reflecting changes in the tax-exempt sector and the tax law."

The IRS advises that as more organizations file the redesigned Form 990, EO examinations will use the updated form to identify non-compliant and potentially non-compliant organizations for examination. The IRS also plans to use the new form to develop more targeted compliance and education programs.

I. Governing Body and Conflicts of Interest

A. Background

1. The Advisory Committee on Tax Exempt and Government Entities, better known as "ACT," is a body of experts that advises the IRS on EO issues. A

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2008 ACT report that noted that the redesigned Form 990 asks numerous questions that are not closely tied to tax compliance. The ACT report recommended, among many other items, that any inquiries about governance should be made in as neutral a manner as possible.¹ The Form 990 should avoid implying that a set of practices is equally appropriate for all reporting organizations.

2. The ACT report also stated that the ACT did not find significant guidance as to how the IRS takes governance issues into account in the examination process.
 3. The 2011 Work Plan states that in 2010, when performing examinations the EO Division began using a check sheet to capture governance practices and the related internal controls of the organizations being examined. The EO Division will analyze the data over the long term to gain a better understanding of how governance practices work in relationship to tax compliance.² Put differently, IRS officials have said that they will focus on responses in Section VI of the Form 990, which deals with governance, to identify which organizations may be noncompliant.
 4. The check sheet is attached to this outline.
- B. Instructions: The introduction to the Part VI instructions does acknowledge that no particular practices are generally mandated under the law. It also acknowledges that whether a certain procedure should be adopted depends on the organization's size, type and culture.
- C. Part VI, Line 1: Identify the number of voting members of the governing body and those that are independent.
1. An independent member of the governing body is a true outsider. "Independence" depends on meeting all of the following criteria:
 - (a) The member was not compensated as an officer or other employee of the organization or a related organization.

¹ Advisory Committee on Tax Exempt and Government Entities, Report of Recommendations (June 2008), *The Appropriate Role of the Internal Revenue Service with Respect to Tax Exempt Organization Good Governance Issues*.

² IRS Exempt Organizations 2010 Annual Report and 2011 Work Plan, p. 27.

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- (b) The member did not receive total compensation or other payments exceeding \$10,000 during the tax year from the EO and related organizations as an independent contractor, other than reasonable compensation for services performed as a member of the governing body.
 - (c) Neither the member, nor any member of his or her family, was involved in a transaction that had to be reported on Schedule L, or was involved in such a transaction with a related organization that would be reportable on Schedule L if the related organization had to file one.
2. The instructions state that if the governing body's authority has been delegated to a committee, then the composition of that committee must be disclosed on a Schedule O supplemental information form.
 3. An IRS 2009 CPE on governance issues states “[t]here is no right answer to the question ‘how many members should a board have?’” The appropriate size depends on aspects including the age of the organization, the nature and geographic scope of mission and activities, the variety of expertise required, and the organization’s fundraising needs.³
- D. Part VI, Line 2: Business Relationships: Did any ODTKE have a family or business relationship with another ODTKE?
1. What is a business relationship?
 - (a) One person is employed by the other in a sole proprietorship or employed by an organization in which the other is an ODTKE or a greater-than-35% owner.
 - (b) One person is entering into business with the other directly or indirectly through loans, leases, sale contracts, performance of services, or other transactions involving more than \$10,000 in the aggregate during the tax year. Indirect transactions involve an organization in which the other person is an ODTKE or a greater-than 35% owner. Entering into business with another is not

³ *Governance and Tax-Exempt Organizations*, 2009 CPE Training.

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reportable if it is in the ordinary course of business, on the same terms as are offered to the public.

- (i) The instructions provide the following example: D and E are both officers in an organization. D is also a partner in an accounting firm, in which his profits interest is only 1/300. He is not an ODTKE of the accounting firm. The accounting firm provides services to the organization, collecting \$100,000 in fees on the same terms as are offered to the public.
 - (ii) D and E do not have a reportable business relationship. The services of D's firm are on terms generally available to the public in the ordinary course of business. Also, D is not an ODTKE and is not a 35% owner.
 - (iii) Similarly, Example 3 of the instructions posits that F and G are trustees of the organization. G bought a \$45,000 car from F, who owns a car dealership, on the same terms applicable to the public and in the ordinary course of F's business. The relationship between F and G is therefore not a reportable business relationship, because the purchase was on market terms.
- (c) Each of the two people is a director, trustee, officer, or greater-than-10% owner of the same business or investment entity.
- (i) Assume that H and J are members of the organization's board. Both are CEOs of publicly traded organizations, and both serve on each other's boards.
2. An organization normally obtains this information through a questionnaire. If an organization has tried to gather information about such relationships by distributing such a questionnaire (including the name, title, date and signature of the responding ODTKE) and instructions, then the organization need not report a relationship.
 3. Evidence that a family controls an EO has provided grounds for a refusal to recognize the tax exemption and as a factor for determining that private inurement is occurring.
 4. The instructions provide an exception for privileged relationships, like attorney-client relationships and doctor-patient relationships. The instructions provide this example: K is a key employee of the organization,

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and L is on the board. L is a greater-than-35% partner in a law firm that provided services to K on a discounted basis. Even though the services provided are not in the ordinary course of business or on terms provided to the public, the relationship between K and L is not reportable because it is privileged.

5. “Family relationships” are not defined in the instructions, but they provide the following example: B is an officer of the corporation and C is a member of the governing body. B is the spouse of C’s sister, i.e., B is the brother-in-law of C. That is a family relationship that must be reported.
- E. Part VI, Line 3: Delegations: Did the organization delegate any duties customarily performed by or under the direct supervision of its ODTKEs to a management company or other person?
1. This does not include delegation of administrative duties, like payroll.
 2. The instructions explicitly exclude investment management, unless the EO conducts these services for others.
 3. Examples of management duties are hiring, firing, budgeting, supervising EO programs, and supervising an unrelated trade or business
 4. The 2009 CPE points out that the purpose of line 3 is to show “who is running the organization.” Has the governing body effectively vested management in another organization or individual?⁴
- F. Part VI, Line 5: Diversion of Assets: Did the organization become aware of a significant diversion of the organization’s assets?
1. “Significant” means that the diversion exceeds the lesser of:
 - (a) 5% of the organization’s gross receipts;
 - (b) 5% of the organization’s total assets at year-end; or
 - (c) \$250,000.

⁴Governance and Tax-Exempt Organizations, 2009 CPE Training, p. 40.

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2. This could include knowledge of theft, embezzlement or fraud. Any organization responding “yes” to this question must complete a Schedule O supplemental response, as carefully and convincingly as possible. Corrective action should be detailed.
 3. This would also include knowledge of an excess benefit transaction, if the threshold was met.
- G. Part VI, Lines 6 and 7: Members or Stockholders: Does the organization have members or stockholders who may elect members of the governing body, and if so, which governing body decisions if any are subject to approval of the members or shareholders?
1. A member also includes any person who receives a share of the EO’s profits or a share of the EO’s net assets upon dissolution. This might be a social club or association.
 2. Should an EO have a shareholder level? Should directors be self-electing?
 3. The style of the question points out that trusts will not have members.
- H. Part VI, Line 9: Contact Information: This question asks only whether there are any ODTKEs listed in the compensation schedule who cannot be reached at the EO’s mailing address. This is intended to protect the privacy and safety of the persons serving.
- I. Part VI, Line 11: Review of Form 990: Has the organization provided the Form 990 to all members of the governing board before filing the form?
1. Email delivery is sufficient as long as the email includes a complete copy of the return. Also, the organization may post the draft form on a password-protected website.
 2. The Form 990 also requires the organization to say what procedure, if any, is in place for the review of the Form 990 by any board member, officer, committee member or management.
 - (a) The instructions and IRS statements do not make it clear which of the officers should review it. Ideally a review by the CEO and CFO would suffice.

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- (b) Often there are time constraints because the Form 990 is not finalized until shortly before the filing deadline. If the Form 990 is emailed to the board shortly before filing, the EO can properly state that it disseminated the Form 990 to board members before filing. However, as to review, the EO would state: "No review was or will be conducted."
 - (c) The IRS's CPE on governance says the process for review will vary based on size, culture and type of organizations. Again, no one size will fit all. A large organization might use a committee, for example.
- J. Line 16: Joint Ventures: Given the increasing business interaction between EOs and for-profits, the Form 990 asks whether the EO has a joint venture investment policy. The goals is to ensure that the EO implements safeguards to protect exempt assets and protect against inurement, private benefit, and prohibited activities like electioneering.⁵
- (a) A joint venture is an "agreement to jointly undertake a specific business enterprise, investment or exempt-purpose activity without regard to
 - (i) whether the organization controls the venture
 - (ii) what the legal structure is; or
 - (iii) whether the venture is treated as a partnership for federal tax purposes.
 - (b) The policy for evaluating a JV should include consideration of:
 - (i) Does the EO maintain sufficient control to ensure that the JV furthers the EO's exempt purposes?
 - (ii) Does the JV prioritize exempt purposes over profits?
 - (iii) Does the JV involve activities that would endanger the EO's exempt status?
 - (iv) Will the contract with the JV partner be arms-length?

K. Schedule L: Reporting of Transactions with Interested Persons

1. An "interested person" generally includes:

⁵ 2009 CPE Training.

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- (a) Current and former ODTKEs and highest compensated employees.
 - (b) For 501(c)(3) and 501(c)(4) organizations, this would also include persons defined as disqualified persons under section 4958. This includes:
 - (i) Any person who in the five years ending on the date of the transaction was in a position to exercise substantial influence over the organization's affairs.
2. Reportable transactions should not include a person's competing duties to the EO and another organization. Schedule L is not meant to capture "conflict of loyalty" issues but rather transactions with direct or indirect financial ramifications for the interested person.
3. Loans: In 2004, the IRS implemented the "Executive Compensation Compliance Initiative" for EOs. The report for that project raised concerns about substantial loans made by EOs to officers, directors, trustees and key employees. The report asked whether these transactions are being reported and whether excess benefits are being incurred.
- (a) As a result, the EO division launched a loan project with 200 compliance checks and 50 single-issue examinations. This spurred additional examinations. From a mere 169 examinations, the IRS assessed over \$5.5 million in section 4958 excess benefit transactions excise taxes.
 - (b) The IRS also assessed more than \$480,000 in employment tax on items of income not previously reported for disqualified persons and employees.
 - (c) Similarly, there were more than \$400,000 in discrepancy adjustments for omitted income on those individuals' returns.
 - (d) Only 22% of the examinations resulted in no change. Organizations are not handling or reporting these transactions correctly.

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4. Grants or assistance benefiting interested persons:

- (a) A “grant” includes the provision of goods, services, the use of facilities, a scholarship, an award, a prize, a fellowship or an internship.
- (b) For purposes of this part of the Schedule L, the definition of “interested persons” is broadened. The grant is reportable if it is made to a current or former ODTKE, a substantial contributor, or a related person.
- (c) A substantial contributor contributed \$5,000 or more and is required to be listed on Schedule B.
- (d) Related persons include members of the grant committee, certain family members of ODTKEs or grant committee members, related entities, and employees of substantial contributors or related entities.
- (e) There is a long list of exceptions, including scholarships or grants to employees and their children made according to established criteria on a nondiscriminatory basis, and grants or assistance made to such persons because they are members of a charitable class whose needs are addressed by the EO’s charitable mission. An example of the latter exception would be disaster relief.
- (f) As in Part VI of the Form 990, the EO is not required to provide information about a grant or assistance if it has been unable to find out about it after making a reasonable effort to obtain information.

5. Business transactions:

- (a) A reportable transaction exists if:
 - (i) all payments for the tax year between the EO and the interested person exceeded \$100,000;
 - (ii) all payments for a single transaction exceeded \$10,000 or 1% of the EO’s total revenue;
 - (iii) compensation payments during the tax year by the organization to a family member exceeded \$10,000; or
 - (iv) in the case of a joint venture with an interested person, the EO has invested \$10,000 or more.

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- (b) Again, who is an interested person for purposes of identifying a suspect business transaction is slightly different. Interested persons include:
 - (i) Current and former ODTKEs;
 - (ii) Family members of current or former ODTKEs;
 - (iii) An entity in which one or more current or former ODTKEs or family members own more than 35%;
 - (iv) An entity in which one or more ODTKEs or family members was an officer, director, trustee, key employee, or partner directly or indirectly owning 5% or more; and a shareholder directly or indirectly owning 5% or more in a professional corporation.
- (c) Management company transactions are also reportable here. These are payments to third party managers in which a former ODTKE of the EO is an ODTKE or a 35% owner.

L. IRS Governance Checklist

1. As mentioned above, the IRS has posted a Governance Check Sheet (attached) that its agents will use in audits of public charities. The check sheet highlights many of the issues that must be reported on the Form 990. Again, the purpose of the check sheet is to determine how governance practices interact with tax compliance.
2. The checklist includes questions that ask for the following information:
 - (a) Does the EO make its governing instruments available to the public and to the governing body?
 - (b) Did the number of times the governing board met exceed what was required under the bylaws??
 - (c) Does the EO require advance approval of compensation, by members of the board or a committee without a conflict of interest?
 - (d) Does the organization rely on comparability data in determining compensation?
 - (e) Is the organization effectively dominated by a few individuals?

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- (f) Does the EO have a written conflict of interest policy?
- (g) Does the organization have a written mission statement that articulates its current purpose?
- (h) Did the organization comply with its own document retention policy, and if not, did lack of compliance hinder the audit?

II. Changes to Organizational Documents

- A. Any “significant” changes to the governing instruments must be reported pursuant to Line 4 of the Part VI governance and management portion of the Form 990.
- B. The list of reportable changes includes:
 - 1. The organization’s exempt purposes or mission;
 - 2. The organization’s name;
 - 3. The number, composition, qualifications, authority, or duties of the governing body’s voting members;
 - 4. The number, composition, qualifications, authority, or duties of the organization’s officers or key employees;
 - 5. The role of the stockholders or membership in governance;
 - 6. The distribution of assets upon dissolution;
 - 7. The provisions to amend the organizing or enabling document or bylaws;
 - 8. The quorum, voting rights, or voting approval requirements of the governing body members or the organization’s stockholders;
 - 9. The policies or procedures contained within the organizing documents or bylaws regarding compensation of officers, directors, trustees, or key employees, conflicts of interest, on whistleblowers, or document retention and destruction; and

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10. The composition or procedures contained within the organizing document or bylaws of an audit committee.
- C. EO Determinations will no longer issue letters confirming that an organization reporting significant will retain their tax-exempt status. Bear in mind that some changes in operations or purposes will require a new application for exempt status.
 1. Section 1.501(a)-1(a)(2) of the Treasury Regulations provides: “Subject only to the Commissioner’s inherent power to revoke rulings because of a change in the law or regulations or for other good cause, an organization that has been determined by the Commissioner or the district director to be exempt under section 501(a) or the corresponding provision of prior law may rely upon such determination so long as there are no substantial changes in the organization’s character, purposes, or methods of operation.”
 2. Conversely, Rev. Proc. 2011-9, which governs applications for tax exemption, states: “A determination letter or ruling recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization, or change in the applicable law.”
 3. Changes to the EO’s purposes or operations that falls short of a “material” or “substantial” change may be reported on the Form 990. These changes should also be documented with the understanding that the organization’s donors and various watchdog groups may review the Form 990.
- D. Note that the organization’s exempt purpose and the language dealing with distribution of assets upon dissolution are governing instrument requirements under the Code. Careful attention is required.

III. Documentation of Actions by the Board

- A. Part VI includes a question (Line 8) whether the organization contemporaneously documented the meetings held or written actions undertaken during the year by the governing body and any committees with authority to act on the governing body’s behalf.
- B. “Contemporaneously” means the later of (i) 60 days after the current meeting or (ii) the next meeting of the governing board or committee.

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- C. The IRS wants to know whether the organization is document (i) its decisions, (ii) the parties who make them and (iii) the rationale for decisions.⁶

IV. Written Policies

- A. Policy Regarding Local Chapters, Branches or Affiliates: Line 10 of Part VI on governance asks if the organization has such chapters, branches or affiliates, and if so, whether written policies exist to ensure that the operations of the branches and affiliates are consistent with those of the organization.
- B. Conflict of Interest
1. Line 12 of Part VI request the organization to state whether it has a written conflict of interest policy in place. As with some other Part VI questions, this question seems to be a prompt.
 2. The IRS's proposed conflict of interest policy is attached. It is found in the instructions to Form 1023.
 - (a) Note that superficial adoption of the IRS's proposed policy was considered in *Ohio Disability Association v. Commissioner*, T.C. Memo 2009-261. The Tax Court refused to issue a declaratory judgment requiring the IRS to recognize the organization as exempt. On the record, the Tax Court could not conclude that the organization would operate exclusively for public benefit.
 - (b) Therefore, the organization should take a thoughtful approach to identifying conflicts of interest.
 - (c) To that effect, line 12c asks whether the EO regularly and consistently monitors and enforces compliance with the policy, and to describe the procedures it uses for monitoring and enforcement.
 - (d) To keep matters private, many organizations choose to monitor conflicts of interest by sending out a questionnaire that helps ODTKEs identify situations that raise a conflict or the appearance of one.

⁶ 2009 CPE Training.

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- (e) Boards may also have the identification of conflicts as a standing agenda item.
- 3. Use of the IRS's form is certainly not required. A conflict-of-interest policy will normally define a conflict, identify the individuals covered, provide one or more methods to help the board members identify conflicts, and specify procedures to manage conflicts.

C. Document Retention Policy

- 1. One of the few applications of the Sarbanes-Oxley Act to EOs is that the Act uniformly imposes criminal liability on destruction of records with the intent to obstruct a federal investigation.
- 2. Any written policy should address what is required under tax law:
 - (a) An EO must keep permanent books of account or records sufficient to establish its gross income, receipts, disbursement, and to substantiate its reporting on Form 990.⁷ With respect to any UBIT return, the organization must substantiate its deductions, credits and other tax items.⁸
 - (b) Records must generally be maintained for at least three years after the later of the due date of the tax for the applicable period, or the date the tax was actually paid.⁹
 - (c) It is nonetheless advisable to keep all EO financial records indefinitely because the IRS has the power to retroactively revoke an EO's exempt status as of the date of its formation.

D. Whistleblower Policy

- 1. These policies allow staff, volunteers and others to report suspected wrongdoing without retaliation. Reportable offenses might include:
 - (a) Theft;

⁷ Treas. Reg. § 1.6001-1(c).

⁸ IRC § 6001.

⁹ Treas. Reg. 31.6001-1(e)(2).

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- (b) Misleading financial reporting;
 - (c) Undocumented transactions;
 - (d) Unreported conflict of interests;
 - (e) Destruction of records; and
 - (f) Improper spending or other financial procedures.
2. The policy should, at a minimum, encourage staff to come forward with credible information. It should inform the staff that the organization will protect the staff member from retaliation, and should identify persons to whom the staff member can report.
 3. The Sarbanes Oxley Act also applies to EOs in this context. It is illegal to punish whistleblowers, whether the organization is an EO or for-profit.
 4. Some states have whistleblower protection rules for EOs. In Illinois, an employer cannot make a rule preventing employees from reporting wrongdoing and cannot retaliate against employees who do so. The law carries civil penalties and requires reinstatement of the employee, back pay with interest, and damages including attorney's fees. 740 ILCS 174/1 *et seq.*

V. Executive Compensation Background

A. Form 990 Requirements:

1. All organizations are required to complete Part VII of the Form 990 and, when applicable, Schedule J.
2. Organizations must generally report “reportable compensation” for current and former ODTKEs, and their five most highly compensated employees.
 - (a) “Reportable compensation” is compensation reported on Form W-2, box 5, and Form 1099-MISC, box 7.
 - (b) “Former” refers to a five-year look back period.

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3. Organizations must report the compensation that they pay to those individuals, along with the compensation paid from related organizations. These include parents, subsidiaries, supporting and supported organizations and “brother/sister” organizations.
- B. Specific Thresholds:
 1. Organizations must report all compensation for all current officers, directors, and trustees.
 2. Compensation to the organization’s top 20 “key employees” is reportable. A person is considered a “key employee” if he or she earns more than \$150,000 in reportable compensation (for the calendar year that ends in the EO’s tax year) and satisfies one prong of a three-part “responsibility test.” The three prongs are:
 - (a) The employee has responsibilities or powers that on the whole are similar to those of an officer, director or trustee;
 - (b) The employee manages a segment or activity that represents 10% or more of the assets, income, or expenses of the organization; or
 - (c) The employee has or shares authority to control or determine 10% or more of the organizations capital expenditures, operating budget, or compensation for employees.
 3. The organization must also list the current five highest compensated employees (other than those named above) who are earning more than \$100,000 of reportable compensation. This may include someone who earns more than \$150,000 but fails the responsibility test, or vice versa.
 4. The organization must also report compensation to former officers, key employees and highly compensated employees who are still earning more than \$100,000 from the EO or related organizations.
 5. Finally, the organization must report payments to former directors and trustees who continue to earn more than \$10,000 from the EO or related organizations.

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- C. The organization must also report its top five highest compensated independent contractors that the organization paid more than \$100,000.
- D. Schedule J, Compensation Information
 - 1. Schedule J must be filed if the organization answered “yes” to Part VII, Line 3, 4 or 5. This means that more information is required if:
 - (a) Compensation to a **former** ODTKE or highly compensated employee was reportable (\$100,000 to former officers, key employees or highly compensated employees, and \$10,000 to former directors or trustees).
 - (b) For any person listed on Line 1a of Part VII (all reportable persons and compensation), the total paid to the person from the EO and related organizations **exceeded \$150,000**.
 - (c) For any person listed on Line 1a of Part VII (all reportable persons and compensation), the person also received compensation from an **unrelated** organization or individual for services rendered to the EO.
 - 2. Only 19% of organizations filing Form 990 included Schedule J. If these returns are correct, this tends to show that the lion’s share of charitable organizations pay modestly.
- E. Indirect Payments. In Announcement 2011-36, the IRS invited comments about the redesigned Form 990. Among other areas, the IRS asked for comments on whether or how fees paid to third-party service providers should be reported as compensation to officers, directors, trustees, or key employees, when the ODTKEs are related to the third-party provider.

VI. Independent Review of Executive Compensation

- A. Line 15 of Part VI asks whether the process used for determining the compensation of the CEO and other officers and key employees include (i) a review and approval of the compensation by independent persons, (ii) use of comparability data and (iii) contemporaneous documentation of the decision.
 - 1. The organization must provide details on Schedule O.

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2. Compensation information also comes up in Part VII of the Form 990 and on Schedule J.
- B. As background, section 4958 of the Code imposes intermediate sanctions – i.e., an excise tax and thus a penalty short of loss of exempt status – on certain disqualified persons who enter into excess benefit transactions with public charities. EO managers with knowledge of the excess benefit can also be subject to sanction.
- C. Payment of excessive salary is an excess benefit transaction. However, a board seeking to protect themselves and the EO may meet a three-prong safe harbor established under the Treasury Regulations.¹⁰ If the board meets the following requirements, then the board has established a rebuttable presumption that the compensation paid is not excessive. An IRS Exempt Organization Executive Compensation Compliance Project commenced in 2004 found that of the organizations studied, 51% of them tried to comply with all three prongs in order to claim the protection of the rebuttable presumption.
 1. The compensation is reviewed and approved by an independent governing body. The 2004 Compliance Project found that in that study, 95% of disqualified persons recused themselves from discussion and approval of their own compensation.
 2. The board commissions comparability studies and relies on that data in determining compensation. The 2004 Compliance Project found that 54% of the EOs studied commissioned these studies in determining compensation. Of the EOs that did so, 97% gathered information about EOs of similar type and size. Also, 97% of those organizations set the compensation at hand within the range of the commissioned data.
 3. The board adequately documents its decision-making process.
- D. Prong 1: The board, authorized body or authorized committee approving the compensation must be composed entirely of individuals who do not have a conflict of interest with respect to the compensation arrangement. These individuals cannot be:
 1. A disqualified person economically benefiting from the compensation, or a member of the family of such a person.

¹⁰ Treas. Reg. § 53.4958-6.

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2. A person in an employment relationship subject to the control of such a disqualified person.
 3. A person who receives compensation or other payments subject to approval by the disqualified person.
 4. A person with a material financial interest affected by the compensation.
 5. A person who does not approve a compensation arrangement for the payee, who in turn has or will approve economic benefits to the person.¹¹
- E. Prong 2: Comparability studies can be commissioned, or board members may collect their own data. Organizations should focus on similarly situated organizations. Sources of applicable data include:
1. ERI (Economic Research Institute): This organization sells search software and also provides surveys. One of its sectors studied is the nonprofit sector.
 2. GuideStar: This nonprofit resource publishes an annual survey that is drawn directly from IRS reporting. The organization classifies nonprofits according to the “National Taxonomy of Exempt Entities,” and then compares compensation across types of EOs, geographical areas, and size of EOs. Sample pages from the 2010 report are available at <http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=2997>.
 3. The Chronicle of Philanthropy frequently reports on nonprofit compensation issues and also provides an annual survey of compensation and benefits to subscribers.
 4. The Council on Foundations reports to its members on compensation practices for grant making organizations.
 5. Charity Navigator provides a free annual compensation survey on its website. This survey includes some specific and unfavorable information, like the highest paid executives in certain sectors, and other charities that report compensation payments to relatives of their CEOs.
 6. Compensation Resources, Inc. recently released a 2011 report for the nonprofit sector.

¹¹ Treas. Reg. § 53.4958-6(c)(1)(iii).

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7. Small organizations with gross receipts of \$1 million or less are considered to have appropriate data if the board gathers data on compensation paid by three comparable organizations in the same or similar communities for similar services.¹²
 8. The IRS announced it intends to focus on the quality of comparables used, of both EO and for-profit organizations that appear in the compensation studies.
- F. Prong 3: The documentation of salary or of a transaction must show:
1. The terms of a transaction and the date;
 2. The members of the authorized body who were present and those who voted on it;
 3. The comparability data obtained and relied upon, and how it was obtained; and
 4. Any actions taken with respect to the transaction by a person who was a member of the authorized body but who had a conflict of interest.¹³

VII. Disclosure Requirements

- A. EOs – specifically those EOs described in sections 501(c) or (d) of the Code and political organizations exempt under section 527(a) – must make available a copy of the annual return for inspection during regular business hours as the organization's principal office and, if applicable, its regional offices.¹⁴
- B. If the organization does not maintain a permanent office, the organization may arrange for inspection at a reasonable location of its choice or mail a copy of the return to the requester in lieu of arranging an inspection.¹⁵

¹² Treas. Reg. § 53.4958-6(c)(2).

¹³ Treas. Reg. § 53.4958-6(c)(3).

¹⁴ IRC § 6104(b), Treas. Reg. § 301.6104(d)-1(a).

¹⁵ Treas. Reg. § 301.6104(d)-1(c)(2).

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- C. The organization must make an annual return available for a three-year period following the later of (i) the actual filing date or (ii) the due date of the return, taking into account any extensions of time to file that were actually granted.
- D. Certain information need not be disclosed.
 - 1. For any EO that is not a private foundation, the EO may keep confidential the name and addresses of its contributors.¹⁶
 - 2. The amounts of contributions and bequests are to be made available for public inspection, unless the EO reasonably expects that this would lead to identification of a contributor.¹⁷
 - 3. Certain returns are not included in the definition of “annual information return.” Among others, this includes Form 990-T, reporting an exempt organization’s business income, and Schedule K-1 of Form 1065.¹⁸
- E. Upon request by a person at the EO’s principal, regional or district office, an EO must also supply a copy of the annual return, without charging more than a reasonable fee for photocopying costs.¹⁹
- F. A person may also request a photocopy of the annual return in writing. In that case, the EO has 30 days to provide the photocopy.²⁰ A written request will be considered made as of seven days of the date of the postmark or, if emailed, on the date of delivery of the email.²¹
- G. Copies of the annual return need not be provided if the EO has made the return “widely available.” This means that the EO has posted the return on its own website or the website of another organization. The image format must reflect exactly what was filed by the EO. Also, the public must be able to print the return without paying for a special program.²² Making the return widely available by web posting it does not relieve an EO of the requirement to permit public inspection of the return.

¹⁶ IRC § 6104(b).

¹⁷ Treas. Reg. § 301.6104(b)-1(b)(2).

¹⁸ Treas. Reg. § 301.6104(d)-1(b)(4)(ii)

¹⁹ IRC § 6104(d)(1)(B).

²⁰ *Id.*

²¹ Treas. Reg. § 301.6104(d)-1(d)(2)(ii)(A).

²² Treas. Reg. § 301.6104(d)-2.

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- H. Note that the IRS provides all Forms 990 to GuideStar, an exempt 501(c)(3) organization that has a mission of increasing transparency, improving EO operations, and encouraging charitable giving. These Forms 990 can be viewed at www.guidestar.org. EOs also supply their Forms 990 directly to Guidestar. This should satisfy the “widely available” requirement.

VIII. Financial Statements

- A. Statement of Revenue. This page of the form divides revenue into (i) contributions, gifts, and grants, (ii) program service revenue, and (ii) other revenue, which includes investment income, royalties, rents, proceeds from asset sales, gross income from sales of inventory, and income from gaming activity.
- B. Statement of Functional Expenses. Column A reports total expenses, while Columns B, C, and D break out expenses related to (i) program services, (ii) management and general expenses, and (iii) fundraising expenses. Naturally, organizations may wish to report the greatest share of their expenses as program expenses, to the extent proper.
1. Program services are those activities that further the organization’s exempt purposes.
 2. For those organizations that lobby in order to satisfy their exempt purposes, lobbying expenses are included as program services.
 3. Program services can include activities that generate UBTI. The instructions give the example of expenses of producing a magazine that supports the organization’s exempt purpose. The magazine also sells advertising, which generates UBTI, but its production is a program service expense.
 4. If an organization applies for a grant or contract to enable it to carry out its exempt purposes or programs, the cost of that process is a program service expense, not a fundraising expense.
- C. Balance Sheet. The organization must report all of its assets, liabilities, and net assets or fund balances as of the beginning of the year and the end of the year.
- D. Schedule A – Public Charity Status and Public Support

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1. Any section 501(c)(3) organization or section 4947(a) charitable trust that is not a private foundation must file Schedule A to characterize itself as a public charity.
 2. For those organizations that qualify as public charities because they receive one-third of their gross receipts as contributions from the public or from carrying out charitable activities, public support is now based on a five-year period. The form provides columns to show the five years of data and resulting calculations.
 3. For purpose of counting support, income will be determined under the accounting method that the EO normally uses in keeping its books.
- E. *Schedule D – Supplemental Financial Statements.* Schedule D includes reporting for various other specific assets and arrangements. EOs that maintain donor advised funds, charitable conservation easements, art collections, endowment funds, and program-related assets will file this Schedule.

IX. Using Form 990 to the EO's Advantage

- A. Part III of the Form 990 appears on the second page of the return. It requires the organization to report its program services and exempt purpose achievements. This also enables the organization to state its mission in a positive way.
- B. The Section VI inquiry requiring reporting of new charitable purposes similarly allows the organization to publicize its goals and achievements.
- C. It may be true that the IRS should not be dictating governance in the guise of questions that appear on the Form 990 and which may not be closely tied to tax compliance. Nonetheless, dealing with these questions positively and accepting the guidance the IRS is clearly providing is unlikely to harm the EO's mission and is quite likely to create or improve an ethical work environment within the organization.

X. What's New and IRS Focus

- A. The IRS has cross-checked EOs that file state gaming permits to determine whether those organizations are filing Forms 990 with the IRS. There have been over 1,300 delinquent returns filed to date.

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- B. Pursuant to the Pension Protection Act of 2006, all tax-exempts must file a Form 990, including those that previously had been free from any filing requirement because they were public charities with gross receipts of less than \$25,000. The IRS has now instituted a program to bring organizations that have not filed in the last three years into compliance.



The information described herein is of a general nature, based on information currently available, and should not be relied upon to make planning, purchase, sale, or exchange decisions without seeking personal professional advice.

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