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A New Era of Reporting for Exempt Organizations

Preparing to File the Revised Form 990

In one of the most significant developments for exempt organizations in recent years, the IRS has issued a completely revised Form 990, the information return filed annually by 501(c)(3) public charities and other tax-exempt organizations. The new Form 990 requires substantial new disclosures regarding virtually every aspect of an exempt organization's operations and will serve as a key tool used by the IRS, state charity officials, and the public to evaluate exempt organizations.

Most exempt organizations will need to undertake significant work to be prepared for filing the new form. Because of the form's extensive disclosures and its availability to the public, responses to certain questions could trigger audit or enforcement action from the IRS or state attorneys general, or provide people unfriendly to the organization with ammunition for negative publicity or a whistleblower suit. By identifying and resolving potential problem areas in advance, however, exempt organizations can mitigate the risk of such problems and turn the Form 990 into a positive public relations tool.

New Format

The IRS had three goals in redesigning the Form 990: (1) to provide the IRS, state officials, and the public with a more transparent picture of the filing organization and its operations; (2) to promote compliance and enable the IRS to efficiently assess the organization's risk of non-compliance; and (3) to minimize the burden on filing organizations by facilitating complete and accurate reporting. The form's new structure and more comprehensive instructions are expected to play a key role in furthering those goals.

The new Form 990 consists of an **11-page core form** that must be completed by all filing organizations and **16 topic-specific schedules** that must be completed only by organizations conducting activities described in certain trigger questions. One of the most significant changes is the **increased emphasis on narrative descriptions and explanations**. In direct response to comments from the exempt organization community, the IRS has moved the expanded mission statement and program service descriptions to the front of the core form and has provided additional space throughout the form for narrative explanations, all of which will serve as the lens through which the financial and other information in the form is viewed. The increased attention on narrative descriptions and explanations means that organizations should be deliberate in drafting their responses for the Form 990.

To promote uniform reporting and help filing organizations report accurate and complete information, the **more comprehensive line-by-line instructions** (to be finalized later in 2008) feature a comprehensive glossary of key terms used in the form and more examples to illustrate definitions and new requirements or to clarify items that may be confusing. The instructions also include a sequencing list to assist organizations in determining the order in which to fill out the form and a compensation table to help organizations determine how and where to report specific items of compensation and benefits.

Areas of Interest

The information required in the new Form 990 falls within several different areas of interest, many of which are summarized below.

Governance, Management, and Public Disclosures.

The IRS believes that the existence of an independent governing body and well-defined governance and management policies and practices increase the likelihood that an organization is operating in compliance with federal law. Accordingly, the new Form 990 places significant emphasis on corporate governance matters and will require each filing organization, among other things, to:

- Disclose the **number of voting governing body members that are “independent”** (i.e., do not receive material financial benefits from the organization).
- Disclose whether the **Form 990** was provided to the governing body prior to filing and describe the process, if any, by which the directors, officers, trustees, committee members or management reviewed the Form 990.
- Disclose whether the filing organization’s **conflict of interest policy** requires directors, officers, trustees, and key employees to make an annual disclosure of interests that could give rise to a conflict and describe how the organization regularly and consistently monitors and enforces compliance with the policy.
- Disclose whether the organization has a **whistleblower policy and document retention and destruction policy**.
- Describe the **processes used to determine compensation** of its top management official, officers, and key employees and, specifically, whether such processes include review and approval by independent persons, use of comparability data, and contemporaneous substantiation of the deliberation and decision.
- If an organization invested or participated in one or more **joint ventures** with a taxable entity or individual, disclose whether the organization has adopted a written policy or procedure requiring negotiation of terms designed to protect the

organization’s exempt status and has actually taken steps to safeguard such exempt status.

- Provide information on its **disclosure practices** with respect to its Form 990, Form 990-T, and Form 1023 or 1024 and disclose how (if at all) it makes its governing documents, conflict of interest policy, and financial statements available to the public.

Compensation. Consolidated and expanded compensation disclosures will increase the transparency of compensation information for all exempt organizations and provide the IRS with more information to assess the reasonableness of compensation. All filers (including non-charitable exempt organizations) now must report in the core form compensation for all current and certain former directors, officers, trustees, key employees, the five highest compensated employees, and the five highest compensated independent contractors. To reduce subjectivity, compensation is now reported for the calendar year ending with or within the organization’s tax year based on Forms W-2 and 1099, although fiscal year institutions will still use the fiscal year methodology to report aggregate compensation on the statement of expenses.

In addition, if certain triggers are met, the filing organization must complete Schedule J, which requires significant new disclosures regarding the organization’s compensation and expense reimbursement practices, as well as a more detailed breakdown of compensation and benefits received by certain individuals. Organizations required to complete Schedule J are likely to experience additional burdens in reporting the required information.

Fundraising. In response to concerns regarding misreporting of fundraising activities, the IRS has introduced Schedule G, which requires expanded disclosures regarding relationships with outside fundraising counsel and professional solicitors and compliance with state charitable solicitation laws. Organizations that receive more than \$15,000 from gaming activities (e.g., bingo, Texas hold’em and other card games, raffles, and casino nights) also will be subject to disclosures regarding their compliance with state gaming laws. The disclosures on Schedule G are

likely to be of interest to state officials responsible for enforcing charitable solicitation and gaming laws.

Organizations that receive more than \$25,000 in non-cash contributions or contributions of specified types of property (including items donated for auction) should take note of new reporting requirements in Schedule M, which are likely to result in more burdensome recordkeeping practices for such organizations.

U.S. Grantmaking. Reporting of U.S. grantmaking activities remains largely unchanged, although organizations that make more than \$5,000 in grants to organizations or individuals in the U.S. must describe their procedures for monitoring the use of grant funds.

Foreign Activities. The new Schedule F requires significant new disclosures regarding the activities of organizations with more than \$10,000 in aggregate revenues or expenses from grantmaking, fundraising, and/or programs in foreign countries. Large organizations with operations in multiple areas of the world likely will be required to implement more extensive recordkeeping practices regarding their foreign activities (including tracking of expenditures by region) in order to comply with the new requirements, although the reporting thresholds will minimize the impact on smaller organizations that simply make limited grants outside the U.S.

Interested Persons and Related Organizations. The IRS shows continued interest in transactions involving insiders and related organizations. The new form consolidates in Schedule L the reporting of most relationships and transactions involving insiders (i.e., current and former directors, officers, trustees, key employees, and other disqualified persons). The new Schedule R requires more extensive reporting with respect to (1) related organizations, their activities, ownership/control, and the filing organization's share in the income and assets of such related organizations and (2) certain unrelated partnerships through which the organization conducted significant activities. These new disclosures are likely to require organizations filing Schedule R to institute new recordkeeping practices.

Tax-Exempt Bonds. To address perceived noncompliance with respect to tax-exempt bonds, the IRS has introduced Schedule K, which requires substantial new disclosures regarding the investment of and expenditures from bond proceeds, as well as private use of bond-financed facilities. The new reporting requirements are expected to impose significant additional reporting burdens on organizations that have borrowed through the use of tax-exempt bonds and other forms of tax-exempt debt.

Hospitals. Organizations operating hospitals must complete the new Schedule H, which requires significant data regarding charity care, community benefits, and community building activities, as well as narrative descriptions of how they assesses the health care needs of the communities that they serve, how they inform patients regarding their charity care policy and eligibility for government assistance, and how they promote the health of the communities they serve. Disclosures regarding bad debt, Medicare payments, collection practices, management companies, and joint ventures are also required. It is likely that Congress and/or the IRS will use the data compiled in Schedule H to assess the need for legislative or regulatory changes regarding the manner in which hospitals may qualify for and maintain exemption, an issue which has garnered significant attention in recent years.

Transition Relief

In recognition of the significant changes brought by the new Form 990 and the modifications to recordkeeping practices that may be necessary, the IRS has provided for the following phase-in periods that will permit certain small organizations to file the simpler Form 990-EZ for tax years beginning in 2008 and 2009.

May file Form 990-EZ for:	If gross receipts are:	And if assets are:
2008 tax year (filed in 2009)	> \$25,000 and <\$ 1 million	< \$2.5 million
2009 tax year (filed in 2010)	> \$25,000 and <\$500,000	< \$1.25 million
2010 and later tax years	> \$50,000 and <\$200,000	< \$500,000

Transition relief also exists for organizations required to complete the new schedules for hospitals (Schedule H) and tax-exempt bonds (Schedule K). For tax years beginning in 2008, filing organizations are required to provide only certain identifying information, with completion of the entire schedules required for tax years beginning in 2009.

Recommendations

To properly position themselves for the first filing of the revised Form 990, exempt organizations should start preparing now by taking the following steps:

1. Educate the governing board and management regarding the new requirements imposed by the Form 990. Develop and formalize a process for the preparation and review of the Form 990.
2. Consider a trial run using 2007 data to expose areas requiring additional recordkeeping, identify potential problem areas, and determine where new or revised narrative descriptions are needed. This is particularly important for hospitals and other complex organizations that are likely to experience a substantial additional burden in preparing the new form.
3. Identify related organizations and joint ventures for which reporting will be required. Work with legal counsel to develop a written policy regarding the organization's involvement in joint ventures.
4. Identify and review financial arrangements with disqualified and other interested persons and restructure problematic arrangements, if possible.

Work with legal counsel to develop a process for evaluating such arrangements to ensure that appropriate safeguards and best practices are implemented.

5. Prepare and ask your governing body to approve a conflict of interest policy, whistleblower policy, and document retention and destruction policy. If such policies are already in place, review and update them as necessary to ensure that they reflect current best practices. Also ask the board to determine the organization's position with respect to public disclosure of the organization's application for exemption, Form 990, governing documents, conflict of interest policy, and financial statements.
6. For organizations engaged in fundraising, work with legal counsel to assess compliance with state charitable solicitation and gaming laws.
7. For grantmaking organizations, ensure that adequate procedures are in place to monitor the use of grant funds.

The goal of each filing organization should be to use the new Form 990 to present as good a public profile as possible. Taking the foregoing steps will go a long way toward turning the Form 990 from a document that invites unwanted attention to one that serves as a positive public relations tool for your organization.

If you have questions about the new Form 990 and what your organization should do to prepare for the first filing, please contact your K&L Gates lawyer for more information and guidance.

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