

Update: Revised Form 990 – Governance Provisions

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The IRS has recently completely revised the Form 990 (Return of Organization Exempt from Income Tax) for the first time in thirty years. Part VI of the revised Form 990, which is found on page 6 of the form, poses several questions related to “governance, management, and disclosure.” While the Internal Revenue Code does not require “good governance practices” as a prerequisite for exemption (in fact, the term “governance” does not appear in the Internal Revenue Code), the IRS believes that tax law compliance necessarily follows when organizations are well governed. Steven T. Miller, Commissioner of the Tax Exempt and Government Entities of the IRS, has recently commented:

The effects of good or bad nonprofit governance cut across virtually everything we see and do in our work. Governance practices influence whether an organization is operated to further exempt purposes, and whether the organization serves public, rather than private, interests.

Good or bad governance dictates whether the organization’s executives are compensated fairly or excessively. It influences whether the organization makes informed and fair decisions regarding its investments or its fundraising practices, or whether it allows others to take unfair advantage.

For most tax-exempt organizations, the revised Form 990 is required for 2008 and subsequent tax years. For organizations on a fiscal year, the revised Form 990 is required for fiscal years that begin in 2008 (or subsequent years). The revised Form 990 is being “phased in” over the next few years. For 2008, tax-exempt organizations with gross receipts of \$1,000,000 or more and/or total assets of \$2,500,000 or more must file the revised Form 990. For 2009, the thresholds are \$500,000 of gross receipts and \$1,250,000 of total assets. For 2010 and subsequent years, they are \$200,000 of gross receipts and \$500,000 of total assets. Tax-exempt organizations that fall below the above-referenced thresholds may file the Form 990-EZ, which is a simplified, condensed version of the Form 990 that has not (yet) been revised and does not include the governance

questions that are included on the revised Form 990. Any organization that has gross receipts of \$25,000 or less must file a Form 990-N instead of a Form 990 or Form 990-EZ.

Part VI of the revised Form 990, which is found on page 6 of the form, poses several questions related to “governance, management, and disclosure.” This Update addresses the questions related to governance on Part VI of the revised Form 990 as well as the policies that the IRS has recommended that tax-exempt organizations adopt.

Part VI, Section A – Governing Body and Management

Section A contains 15 questions related to the governing body (e.g., Board of Directors) and the management (e.g., officers) of the organization. These include questions related to the number of voting directors, whether any directors or officers have family or business relationships, whether the organization has made any changes to its governing documents (e.g., Articles of Incorporation or Bylaws) during the tax year, how the directors are chosen and whether the decisions of the Board of Directors are subject to oversight, whether minutes were kept of meetings of the Board of Directors, and whether final copies of the Form 990 were provided to the directors before it was filed. We generally recommend that tax-exempt organizations do the following:

- Ensure that the governing documents, such as the Articles of Incorporation and Bylaws, are current and the procedures set forth in the governing documents, including the method for choosing directors and the number of directors, are followed.
- Do not permit any individuals or other organizations to have oversight or veto power over the decisions of the Board of Directors.
- Ensure that the Board of Directors has regular (i.e., at least annual) meetings, and that minutes are kept of all board meetings or committee meetings.

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- Full, final copies of the Form 990 with all exhibits, statements, and other attachments should be provided to each director in advance of its filing. Each director should review the form and provide any comments prior to its filing.

Part VI, Section B - Policies

Section B contains 10 questions related to the governance policies that the organization has in effect. These policies include a conflict of interest policy, a whistleblower policy, a document retention and destruction policy, a compensation policy, and, if the organization engages in joint ventures with taxable entities, a joint venture policy. We generally recommend that tax-exempt organizations adopt the following policies:

- *Conflict of Interest Policy.* This policy sets forth what is considered a potential conflict of interest and the procedures for directors and officers to follow if a potential conflict of interest exists.
- *Conflict of Interest Disclosure Statement.* Each year, each director and officer should sign a statement indicating that they have received and reviewed the organization's Conflict of Interest Policy. They should also indicate that they either have no potential conflict of interest or, if a potential conflict of interest exists, it should be disclosed on the Conflict of Interest Disclosure Statement. In addition, should any potential conflict of interest arise during the year, the director or officer should complete a new Conflict of Interest Disclosure Statement that indicates the potential conflict of interest.
- *Whistleblower Policy.* A Whistleblower Policy is intended to encourage employees, volunteers, and other individuals associated with the organization to report illegal activity or violations of the organization's policies. A Whistleblower Policy should provide a designated employee, officer, or director who is responsible to whom such reports may be made. It should also provide a procedure for investigation of complaints, protection from retaliation against the reporting individual, and procedures for the reporting individual to follow if the designated employee, officer, or director does not or is unable to properly investigate the report in a timely manner. A Whistleblower Policy may also allow reporting on an anonymous basis. In addition, the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") includes provisions applicable to both non-profit and for-profit organizations that provide protections for whistleblowers who work for non-profit organizations and imposes criminal penalties for actions taken in retaliation against whistleblowers who report wrongdoing in good faith. A Whistleblower Policy should include provisions so that it complies with all of the requirements of Sarbanes-Oxley.
- *Document Retention and Destruction Policy.* A Document Retention and Destruction Policy sets forth the number of years for which the organization should retain various types of documents, and the timing and procedures for the regular destruction of documents after these terms have elapsed. A

Document Retention and Destruction Policy should be adopted and its procedures should always be followed. In addition, Sarbanes-Oxley makes it a crime to alter, cover up, falsify, or destroy any document (or persuade someone else to do so) to prevent its use in an official proceeding. As such, a Document Retention and Destruction Policy should be carefully drafted to ensure that its provisions comply with the requirements of Sarbanes-Oxley.

- *Compensation Policy.* Compensation of officers and select employees has been a "hot topic" recently, both with the IRS and in the general news media. Paying excessive compensation to these individuals can result in significant penalties to the organization. In order to avoid these penalties, organizations should create a "rebuttable presumption of reasonableness," as defined in the Treasury Regulations. An organization must take three steps in order to avail itself of the presumption: (1) the compensation must be approved in advance the members of the Board of Directors (or Compensation Committee) that are "disinterested" in the transaction (i.e., a director should not participate in setting his or her own compensation); (2) the Board of Directors (or Compensation Committee) should rely on comparability data (which can be obtained through the hiring of a consultant); and (3) the Board of Directors (or Compensation Committee) should contemporaneously document its decisions with relation to setting compensation. A Compensation Policy should include each of these three elements so that the organization can avail itself of the presumption.
- *Joint Venture Policy.* Organizations that enter into joint ventures or partnerships with taxable entities should adopt a Joint Venture Policy so as to ensure that they safeguard their tax-exempt status by retaining control over the joint venture, requiring that the joint venture prioritize exempt purposes over maximization of profits, prohibit the joint venture from engaging in activities that would jeopardize the organization's tax-exempt status, and provide that all contracts entered into with the organization be on terms that are at arm's length (or are more favorable) to the organization.

Part VI, Section C - Disclosure

Section C includes four questions related to public disclosure of some of the organization's documents. Questions in this section include the states with which a copy of the Form 990 is filed, the methods by which the Form 990 is made available to the public, how the organization makes its governing documents and financial statements available to the public, and information regarding the individual who possesses the books and records of the organization. Tax-exempt organizations should comply with the following requirements:

- The Internal Revenue Code and the Treasury Regulations require that a copy of the Form 990 be provided to the Attorneys General of any state: (1) to which the organization is required to submit reports concerning its organization, assets, or activities; (2) with which the organization has

registered as a holder of property devoted to a charitable purpose; (3) in which the principal office of the organization is located; and (4) in which the organization was formed.

- Disclosure of an organization's Form 1023 (application for exemption), annual Forms 990, and Forms 990-T (to report unrelated business income tax, if any) is required by the Internal Revenue Code and the Treasury Regulations upon a request by any member of the public. In addition, the IRS recommends that tax-exempt organizations make these documents available on their websites.
- While most states do not require that an organization's governing documents, financial statements, and various governance policies be publicly available, the IRS recommends that organizations provide these documents to the public via the same methods that they use for their Forms 1023, 990, and 990-T. It is a "best practice" to post this information on the organization's website.

Other Guidance

While Part IV of the Form 990 does not specifically address these areas, the IRS has strongly recommended that organizations implement the following:

- *Mission.* The IRS suggests that tax-exempt organizations have a "clearly articulated mission" that is adopted by its Board of Directors. Based on the Mission, the organization should set strategic goals for the organization and update them annually.

- *Fundraising Policy.* The board of directors should adopt and monitor a Fundraising Policy to ensure that fundraising solicitations meet federal and state law requirements and solicitation materials are accurate, truthful, and candid. The IRS indicates that tax-exempt organizations should keep their fundraising costs reasonable. In selecting paid fundraisers, a tax-exempt organization should use those that are registered with the state and that can provide good references. Performance of professional fundraisers should be continuously monitored.
- *Gift Acceptance Policy.* A Gift Acceptance Policy sets forth the terms upon which non-cash gifts, such as artwork, automobiles, buildings, and so forth will be accepted by the organization and should allow for some flexibility in handling each potential gift. A Gift Acceptance Policy also sets forth the organization's role in gift administration.

Conclusion

As discussed above, none of the foregoing governance provisions are required by the federal tax laws applicable to tax-exempt organizations. However, failure to comply with these "suggested" best practices may raise a "red flag" with the IRS. Therefore, it is important for tax-exempt organizations to follow the procedures outlined above and adopt the recommended policies. We encourage you to consult our Philanthropic and Nonprofit Department if you would like to discuss these provisions further or are interested in adopting any of these policies for your organization.

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