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2010

# Preserving Tax Exempt Status for Your Nonprofit Client

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## Preserving Tax Exempt Status for Your Nonprofit Client



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**I**n a time of economic recession when man-made and natural catastrophes seem to follow one upon the other the importance of nonprofits as a vital resource to our economy and our citizenry cannot be overestimated. The United States has recently seen massive growth in nonprofit organizations and philanthropy. According to the National Center for Charitable Statistics (NCCS), there were 1.47 million nonprofit entities in 2006 in the United States, and this number is growing at 3.6 percent per year. In 2004, NCCS statistics showed that U.S. nonprofit entities accounted for \$1.1 trillion in revenues, and roughly 8.3 percent of the total U.S. salaries and wages. In Arkansas alone, there are 13,862 registered nonprofit organizations, a 33 percent increase from 1999.<sup>1</sup>

As vital as American nonprofits have become, there is an insidious threat to the existence of many. The danger is that a significant number of them may unwittingly lose the benefit of their tax-exempt status because of changes to the tax code and institutional inattention to filing deadlines for the revised 990. The revised tax law requires most nonprofits to file a Form 990 return each year. Failure to file for three years consecutively results in the loss of tax-exempt status.<sup>2</sup> This has begun to happen, and as this happens the ultimate victim will be the American public who benefit from the charitable work that nonprofits perform. This article is about the protection and preservation of those at-risk nonprofits. It is intended to alert the bar to the 990 issue and assist Arkansas attorneys in helping nonprof-

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1. National Center for Charitable Statistics, [www.nccs.urban.org](http://www.nccs.urban.org) (last visited June 28, 2010).

2. 2009 Instructions for Form 990, *New penalty provisions for nonfiling*, "If an organization fails to file an annual return or notice as required for 3 consecutive years, it will automatically lose its tax exempt status." pg. 8.

its comply with the tax code and avoid the loss of tax-exempt status.<sup>3</sup>

## I. Introduction to the IRS Form 990

Corporate scandals have become a fact of life in this country and a part of what we hear on the news every day.<sup>4</sup> These scandals have caused lawmakers to take some preventive action in the for-profit world.<sup>5</sup> In the nonprofit world, the revised 990 promotes greater transparency in programs and transactions in a way that discourages fraud and helps to protect organizations from wrongdoers.<sup>6</sup> Because the assets and revenues of nonprofits are held in trust for the accomplishment of the organization's primary purpose, the public deserves and demands accountability.

Donors, members, volunteers, and public officials all want to know how contributions to nonprofits are being collected, invested and spent.

The IRS has made the first major changes to the 990 Form, also called the 990 Core Form (hereafter "990"), in nearly thirty years. Some items on the form remain the same, while others have changed. Every nonprofit organization stands to gain by learning more about what is now required by the IRS in order to maintain their tax exempt status.<sup>7</sup>

These revisions take nonprofit transparency to a new level. The new form encourages nonprofits to adopt policies regarding whistleblowing<sup>8</sup> and in many ways demands that nonprofits keep accurate and complete business records.<sup>9</sup>

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3. On July 26, 2010, the IRS released guidance for small nonprofits at risk of losing tax-exempt status. See <http://www.uacted.uark.edu/legalesource/index.html> and <http://www.irs.gov/charities/article/0,,id=225702,00.html> (last visited August 6, 2010). The University of Arkansas School of Law Legal Clinic is a valuable resource to attorneys who wish to assist nonprofits. In addition, Legal eSource™ is an internet site designed and developed by the law school in partnership with the University of Arkansas' Global Campus and Care Foundation to help nonprofits in Arkansas.

4. See, e.g., Jessica Reeves, *The Marc Rich Case: A Primer*, TIME MAGAZINE, February 13, 2001, <http://www.time.com/time/nation/article/0,8599,99302,00.html> (discussing Marc Rich's indictment and pardon for allegedly evading \$48 Million in taxes, 51 counts of tax fraud, and running illegal oil deals with Iran during the hostage crisis); Morley Safer, *The Madoff Scam: Meet the Liquidator*, 60 MINUTES (CBS NEWS) at pp. 1-4, September 27, 2009, <http://www.cbsnews.com/stories/2009/09/24/60minutes/main5339719.shtml?tag=currentVideoInfo;segmentUtilities> (discussing Bernie Maddoff and how he ran the largest Ponzi Scheme in history) (last visited June 28, 2010).

5. *Sarbanes-Oxley Act of 2002*, 18 U.S.C §1513(e) and 1519, H.R. 3763, S. 2673, Pub. L. No. 107-204, 117 Stat. 745, "To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." July 30, 2002. For a discussion of the differences between for-profits and nonprofits and the inappropriateness of Sarbanes-Oxley-type provisions in the nonprofit context, see Robert A. Britton, *Making Disclosure Regulation Work in the Nonprofit Sector*, 2008 U. ILL. L. REV. 437 (2008).

6. 2009 Instructions for Form 990, *Tip*, "while the federal Sarbanes-Oxley legislation generally does not pertain to tax-exempt organizations, it does impose criminal liability on tax-exempt organizations for (1) retaliation against whistleblowers that report federal offenses, and (2) for destruction of records with the intent to obstruct a federal investigation." pg. 20.

7. See Lisa A. Runquist & Michael E. Malamut, *The IRS's New Regulation of Nonprofit Governance: The Annual Form 990 is Now Much More than a Tax Return*, BUSINESS LAW TODAY, July/Aug 2009, at 29; Eric M. McNeil, *The Redesigned Form 990-Key Issues for Tax-exempt Healthcare Organization to Consider Today*, THE HEALTH LAWYER, April 2008, at 14.

8. See Internal Revenue Service, *Governance and Related Topics- 501(c)(3) Organizations*, February 4, 2008, ("The Internal Revenue Service encourages the board of directors to adopt an effective policy for handling employee complaints and to establish procedures for employees to report in confidence any suspected financial impropriety or misuse of the charity's resources").

9. IRS Form 990, *Return of Organization Exempt from Income Tax*, Part VI, Section A, Line 5, and Section B, Line 13. (These questions call for disclosure of any diversion of funds and ask whether the organization has a whistleblower policy, respectively).

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The revised 990 promotes consistency both in record keeping and accounting methods.<sup>10</sup> That means that financial information can more easily be transferred to the 990 without a change in format. Finally, the new form requires organizations to reveal more about their operations and document the flow of revenue.

Records of each organization that has filed its 990 and a copy of the filed 990 form can be found on various websites available to the public.<sup>11</sup> Many donors, especially those seeking to donate large sums, investigate an organization prior to offering a substantial gift. The public availability of this financial information encourages nonprofits to complete the form, and complete it accurately. These reasons alone make it important for an organization to hire an experienced preparer for the 990 who is informed of the recent changes to the form.

The revised form is longer (from 9 pages to 11 pages) and also asks filers to duplicate information. The information in Part I is taken from other parts of the return, then summarized on the front page. The Core Form consists of 11 pages plus several schedules identified alphabetically from A to R with schedules P and Q reserved for future use. Part IV provides a checklist to assist filers in determining which schedules to complete.

While it may seem as though the revised form has only recently been announced, the truth is that there have been a number of drafts with periods for comment leading up to the final version. In June of 2007 the IRS released the draft redesigned 990. Additional drafts followed in December of 2007 and April 2008 before the final version was released in August of 2008. The new form became effective on December 31, 2008.

## II. Overview

### A. Who Must File

Organizations exempt from income tax under section 501(a) must file an annual information return (Form 990 or Form 990-EZ) or submit an annual electronic notice (Form 990-N) unless specifically excluded from the filing requirement. This includes an organization that has not applied for recognition of exemption if it has gross receipts of one half million dollars or assets of \$1.25 million at the end of the tax year.<sup>12</sup>

The filing requirement applies to organizations described in section 501(c)(3)<sup>13</sup> except private foundations.<sup>14</sup> All organizations described in other 501(c) subsections must also file other than black lung benefit trusts.<sup>15</sup>

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10. See Internal Revenue Service, *Governance and Related Topics- 501(c)(3) Organizations*, February 4, 2008, "Charities are required by the Internal Revenue Code to keep books and records that are relevant to its tax exemption and its filings with the Internal Revenue Service."

11. Examples of websites that contain public record Form 990 information include: Guidestar, <http://www.guidestar.org>; National Center for Charitable Statistics, <http://nccs.urban.org>; 990 Finder, <http://tfen.fdcenr.org/990s/990ssreach/esearch.php>; Charity Navigator (This site will rate charities based on the information provided in form 990), <http://www.charitynavigator.org>; Board Source, <http://www.boardsource.org>.

12. 2009 Instructions for Form 990, *Who Must File*, pg. 4.

13. For purposes of Form 990 reporting, the term 501(c)(3) includes organizations exempt under 501(e),(f),(k), and (n).

14. A private foundation, including a private operating foundation exempt under section 501(c)(3) and described in section 509(a), must file Form 990-PF.

15. A black lung benefit trust described in section 501(c)(21) must file the 990-BL return.

An organization that normally has gross receipts of \$25,000 or less must submit the Form 990-N unless the organization has chosen to file the 990 or 990-EZ. An organization eligible to file either the 990-N or 990-EZ may choose to file the 990 (Core) Form; however, it must be completed in its entirety.

Certain organizations are not obligated to file the 990 or 990-EZ despite meeting the threshold filing requirements for gross receipts and total assets. Included in this group are certain religious organizations,<sup>16</sup> governmental organizations,<sup>17</sup> organizations with limited gross receipts,<sup>18</sup> and foreign organizations.<sup>19</sup> In addition, there are types of organizations that file different kinds of annual information returns.<sup>20</sup>

## B. Who Must File Electronically

Small organizations and very large organizations are required to file electronically. Beginning in 2008, organizations with gross

receipts of \$25,000 or less are required to file the Form 990-N, known as the ePostcard.<sup>21</sup> The 990-N cannot be submitted to the IRS in a print format. Print submissions are deemed not filed and subject to penalties.<sup>22</sup>

E-filing is also required for larger organizations that file *at least* 250 returns of any type during the calendar year *and* have \$10 million in total assets as of the end of the tax year. Other organizations may elect to file the 990 electronically. If the organization files electronically, all related forms, schedules, and attachments must be e-filed.

## C. When to File

If the organization's fiscal year is on a calendar year basis and ends December 31st, the filing date is May 15th.<sup>23</sup> If the fiscal year is other than a calendar year basis, the filing date is on the 15<sup>th</sup> day of the 5<sup>th</sup> month following the end of the fiscal year.<sup>24</sup>

16. 26 C.F.R. § 1.6033-2(h). Examples include a church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church, such as a men's or women's organization, religious school, mission society, or youth group.

17. See 26 U.S.C. § 115 and Rev. Proc. 95-48, 1995-2 C.B. 418. Examples include certain state institutions, a governmental unit or affiliate of a governmental unit, an instrumentality of the United States that is exempt from federal income taxes as described in 501(c)(1) and certain political organizations.

18. Any organization with gross receipts that are normally \$25,000 or less. See Appendix B to determine whether an organization meets this test.

19. This group includes international organizations and organizations located in U.S. Possessions with gross receipts from U.S. sources that are normally \$25,000 or less *and* which did not engage in significant activity in the United States other than investment activity. See Rev. Proc. 94-17 and Rev. Proc. 2003-21.

20. Examples include a private foundation or private operating foundation using Form 990-PF; a black lung benefit trust using Form 990-BL; a section 501(d) religious or apostolic organization using Form 1065; and a stock bonus, pension, or profit-sharing trust qualifying under section 401 using Form 5500. See *supra* note 14 & 15.

21. 2009 Instructions for Form 990, *Who Must File*, Form 990-N, pg. 4.

22. 2009 Instructions for Form 990, *Electronic Filing*, "If an organization is required to file a return electronically but does not, the organization is considered not to have filed its return, even if a paper return is submitted." pg. 7. See also, 26 CFR 301.6033-4T, *Required use of magnetic media for returns by organizations required to file returns under section 6033 (temporary)*.

23. 26 U.S.C. § 7701(23), "The term 'taxable year' means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the taxable income is computed ...".

24. 26 U.S.C. § 7701(24), "The term 'fiscal year' means an accounting period of 12 months ending on the last day of any month other than December."

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### D. Describing the Organization's Operations

Form 990 requires a description of the organization's operations. By educating the nonprofit's staff and board regarding the need for gathering the necessary information, the data needed for completion of the 990 will be at hand when it is time to file. Counsel should meet with the nonprofit client in advance to ensure that the information that is being collected and the policies and procedures that are in place will be sufficient to provide what is needed for filing. The primary focus of the form centers on corporate governance and the board of directors. In fact, the greater a nonprofit's revenue and assets, the more detailed the requirements.<sup>25</sup>

Information about the nonprofit's policies will be addressed more specifically later in this article. The timetable for adopting policies is important. Because the 990 relates to the tax year, it is important that policies be adopted before the end of the tax year or as soon as possible thereafter. If the organization needs to modify or adopt policies, a board meeting may be needed.

If board members cannot physically meet in the same place, they can vote by teleconference, submit written consents to action,<sup>26</sup> or vote by proxy.<sup>27</sup> The organization's minutes must reflect the adoption of the new policies.

### E. Filing, Late Filing, and Failure to File

An organization that fails to file a required return or notice for three consecutive years will automatically lose its tax exempt status. In 2010, revocations will start for organizations not filing for the third consecutive year. An organization that loses its exemption is subject to income tax.<sup>28</sup>

The IRS considers an incomplete filing to be a late filing.<sup>29</sup> If the organization is required to e-file, and mistakenly files a print form, the organization is deemed not to have filed by the IRS.<sup>30</sup>

The penalties against the organization for failure to file relate to the size of the organization. If gross revenues are \$1 million or less, the penalty is \$20 per day not to exceed the smaller of \$10,000 or 5% of gross revenues.<sup>31</sup>

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25. See *infra* Figure 1.

26. ARK. CODE ANN. § 4-33-704(c) *Action by written consent*, "A consent signed under this section has the effect of a meeting vote and may be described as such in any document ...".

27. ARK. CODE ANN. § 4-33-724, "Unless the articles or bylaws prohibit or limit proxy voting, a member may appoint a proxy to vote or otherwise act for the member by signing an appointment form either personally or by an attorney-in-fact."

28. See *supra* note 2.

29. See Internal Revenue Service, *EO Reporting Requirements: Incomplete Returns*, <http://www.irs.gov/charities/article/0,,id=139226,00.html>, ("The IRS treats an incomplete return the same as a return filed late – the penalties are the same.").

30. 26 U.S.C. § 6652(c)(1)(A), "... on the date and in the manner prescribed" (emphasis supplied). See also Instructions for Form 990, *Electronic Filing*. "If an organization is required to file a return electronically, but does not, the organization is considered not to have filed its return, even if a paper return is submitted." pg. 7. See also, IRS Regulations section 301.6033-4.

31. 26 U.S.C. § 6652(c)(1)(A)(ii) "The maximum penalty under this subparagraph on failures with respect to any 1 return shall not exceed the lesser of \$10,000 or 5 percent of the gross receipts of the organization for the year."

If gross revenues are over \$1 million, the penalty is \$100 per day with a maximum penalty of \$50,000.<sup>32</sup>

There is an exception if the organization can show "reasonable cause."<sup>33</sup> At least one court has ruled that courts have no authority to reduce the penalties imposed for late filing.<sup>34</sup> Counsel must be aware that there is personal liability for preparers and criminal penalties for false swearing and perjury for filers.<sup>35</sup>

For the organization, failure to file can result in a loss of confidence in the organization's leadership, truthfulness, and transparency. To allow organizations time to adjust more easily to the 990, the IRS adopted a three-year transition period.<sup>36</sup> The organization's filing requirements are tied to the nature of its specific charitable activities.<sup>37</sup>

The filing thresholds have been increased to give organizations time to educate themselves and prepare to file the new form. During this three-year transition period, organizations with more than \$25,000 in gross receipts are given more of an opportunity to use

the Form 990-EZ before converting to the 990 Core Form.

The chart below (Fig. 1) shows the softer initial threshold for use of the Form 990-EZ for the 2008 tax year.

File Form 990-EZ for.....	If gross receipts are less than.....	And if total assets are less than....
2008 (generally filed in 2009)	\$1,000,000	\$2,500,000
2009 (generally filed in 2010)	\$500,000	\$1,250,000
2010 or later	\$200,000	\$500,000

The ceilings for gross receipts and total assets that permit use of the 990-EZ for the 2008 tax year were increased tenfold over 2007. The gross receipts cap rose from \$100,000 to \$1 million, and the cap on total assets was increased from \$250,000 to \$2.5 million. In 2009 and 2010 the ceilings for gross receipts and total assets drop dramatically.

For the 2009 tax year, the dollar cap for gross receipts and total assets are cut in half to \$500,000 and \$1.25 million, respectively. For 2010, the dollar cap for gross receipts drops by 60% to \$200,000. The cap for total

32. *Id.*

33. 26 U.S.C. § 6652(c)(4); *See also* Internal Revenue Service, *EO Reporting Requirement: Abatement of Late Filing Penalties*, <http://www.irs.gov/charities/article/0,,id=139227,00.html> (the applicant for abatement of late filing penalties must explain what prevented the timely filing of the return and provide supporting documentation).

34. *Service Employees International Union v. United States*, 598 F.3d 1110 (9th Cir. 2010) ("Holding that district court lacked discretion to reduce penalty on late filing of informational returns"). *See also* 14A Jerome Wahler, *MERTEN'S LAW OF FED. INCOME TAX* § 55:6.

35. 26 U.S.C. §§ 7206, 7207 "Any person who willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter ...". Violation of the statute can result in a "felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than three years, or both, together with the costs of prosecution."

36. *See supra* note 2. *See also infra* Figure 1.

37. *E.g.*, Schedule H is to be used by organizations that are hospitals; Schedule E is to be used by organizations that are educational institutions, etc.

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assets drops to \$500,000. The result is that each year an increasing number of nonprofits are required to convert from the 990-EZ to the 990 Core Form.

### III. Practice Pointers and Helpful Resources

#### A. The IRS website

The IRS website is a great source of information. Go to [irs.gov](http://irs.gov) and click on the Charities and Non-Profits link. There are search engines to help you find forms and information, as well as mini-courses that are instructive and will take you step by step through the new form. The hypertext link for the mini-courses beneath the photo in purple is no longer functional, and the mini-courses are now being made available through a special part of the IRS website.<sup>38</sup>

There is also an e-file link at bottom left which is the 3<sup>rd</sup> bullet point down under IRS Resources.<sup>39</sup> A list of the forms that can be filed electronically is provided. Charities and non-profits can file the following forms electronically through an Approved IRS 990-e-file Provider.<sup>40</sup>

#### B. Matching Similar Provisions

Part I provides the summary information. If the organization is a corporation, check its

charter for information about the organization. The tax exemption of the organization should conform to the articles of incorporation and the IRS ruling letter. The same holds true for an unincorporated nonprofit association's Articles of Association. The organization's "mission" should match the description of its mission in the bylaws and on its website.

#### C. Key Terms and Definitions

There is a Glossary of Terms that is very helpful located in the 990 print form and online at [irs.gov](http://irs.gov). Some terms take on greater importance. Terms of art are in **bold** in the instructions. For example, the term "independent voting member" is a term of art with a specific definition found in the 990's *Glossary of Terms*.<sup>41</sup>

#### D. Approach to Preparation

The 990 is arranged in such a way that filers should end with Part I. The IRS provides a sequencing list to complete the forms and schedules. The list streamlines the process and eliminates going back and forth between parts of the form for calculations.<sup>42</sup>

Most of the information needed for Part I comes from other parts of the form. The top of the form provides for entry of the organization's basic identifying information including name, address, EIN, tax-exempt status, and

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38. See <http://www.stayexempt.org> (last visited June 28, 2010).

39. <http://www.irs.gov/efile/article/0,,id=108211,00.html> (last visited June 28, 2010).

40. Another helpful resource for attorneys representing nonprofit clients is the website for the Arkansas Coalition of Excellence. This page will assist in filing the 990. (This service incurs a fee).

41. A voting member of the governing body is "independent" if all three of the listed circumstances apply at all times during the organization's tax year.

42. 2009 Instructions for Form 990, *Sequencing List to Complete the Forms and Schedules*. "In general, first complete the core form, and then complete alphabetically Schedules A-N and Schedule R except as provided . . . Schedule O should be completed as the core form and schedules are completed ...". pg. 6.



type of organization. If the organization has a website, the URL for the site must be listed. It is important that the content of the site be consistent with the organization's purposes and the content of the 990 return.

### **E. Signature Block**

An officer or trustee of the organization must be authorized to sign the return. The definition of "officer" for purposes of Part II (Signature Block) is different from the definition of the term "officer" found in the Glossary which is used to ascertain which officers report on other parts of the form and schedules.<sup>43</sup> Even a person authorized by Form 2848 (Power of Attorney) may not sign the return unless that person is an official who is authorized to sign the return.

### **IV. Reporting Revenue and Summarizing Activities**

Part III is the organization's opportunity to give a summary of its program service accomplishments. This is the place to report grant and revenue information along with any expenses. Any new, discontinued, or altered activities are described on Schedule O. Prudent organizations who maintain accurate business records should have an easy time with Part III because they will be able to match the exact expenses for each program with the program described as completed or in progress.

New programs that the organization is launching should be reported here. E-filers have two additional pages to describe their mission and related program activities. The information on the form should reveal, to the extent possible, that the organization is efficient and effective.

Organizations may choose to file the 990 Core Form electronically. E-filers are permitted to attach any related forms, schedules, and attachments, or other electronic attachments of links to websites. This is particularly important for e-filers because an attempt to submit information in this way would result in the filing being deemed incomplete and result in penalties for failure to file.<sup>44</sup>

Down the left hand side of Part III there is a space for insertion of a code that would presumably correspond to the expenses that follow for the three largest program services. These code numbers are not required in filings for the 2008 and 2009 tax years, so leave this section blank if the return is for these years.<sup>45</sup>

The codes are used for the compilation of statistical data and are being studied and reformulated. In future years preparers will want to check the 990 instructions carefully to see whether the codes will be needed.<sup>46</sup>

### **V. Checking the Checklist of Schedules**

Part IV of the 990 provides a checklist of required schedules. Schedules A and B are

43. 2009 Instruction for Form 990, *Signature Block*, pg. 10.

44. *See supra*, note 30.

45. Instructions for Form 990, pg. 11.

46. 2009 Instructions for Form 990, *2009 Changes*, "In Part VIII, Statement of Revenue, the instructions for lines 2 (program service revenue) and 11 (miscellaneous revenue) direct filers to report on those lines codes from a new Appendix J, Business Activity Codes, which are derived from the North American Industry Classification System (NAICS) codes." pg. 2.

retained from the old Form 990. Schedules C through O and R are all new, while schedules P and Q are reserved for future use. The schedules should make the form easier to complete. Very few organizations will fill out all the schedules.

The questions in Part IV indicate whether a schedule is to be completed by the filer. In a few instances, reference to the instructions may still be necessary. For example, question 2 asks whether the organization is required to complete Schedule B listing contributors. To answer that question may require reference to page 12 of the 990 instructions where a fuller explanation of which organizations must list contributors is provided.

The scope of this article is limited in its treatment of the schedules. Some schedules warrant additional comment because they are more likely to require completion by many non-profits.

Schedule A must be completed by all public charities. This schedule supports the basis for the organization's claim to public charity status. There are multiple support tests, and the tests are different depending on whether the particular organization is classified as a private foundation, private operating foundation, or a public charity.

### A. Public Support Tests

Public charities may meet the public support test in a number of ways. To qualify as

a section 509(a)(1) organization, an organization must receive *at least* one-third of its support from government or general public sources, or it may qualify under an alternative test called the "facts and circumstances" test.<sup>47</sup> Under this test the organization must receive at least 10% of its support from governmental units or public sources *and* establish that it normally receives a substantial part of its support from governmental units or public sources.

To qualify as a 509(a)(2) organization, an organization must receive *more than* one-third of the organization's support from a combination of gifts, grants, contributions, membership fees, and gross receipts from performing exempt functions.<sup>48</sup>

If an organization fails to meet the public support test for 2 years, the organization may be reclassified as a private foundation. There are exceptions to this rule, so professional advice on this issue is strongly advised.

## VI. Non-cash Contributions

Schedule M requires information regarding the organization's policy on non-cash contributions. There are policy examples that can be found online.<sup>49</sup> It is important that counsel review the nonprofit's policy and either draft a policy or adapt a template for adoption by the organization.

47. See 26 U.S.C § 509(a)(1).

48. 26 U.S.C. § 509(a)(2), "a domestic or foreign organization described in section 501(c)(3) other than an organization described in section 179(b)(1)(A) other than clauses (vii) and (viii) . . ." (e.g., churches, educational institutions, medical research facilities, governmental units).

49. [www.nonprofitrisk.org](http://www.nonprofitrisk.org) (There are related fees) (last visited June 28, 2010); [www.ace.org](http://www.ace.org) (Membership required) (last visited June 28, 2010).

## VII. Other Schedules

- Schedule B has not changed. It is used by organizations that file Form 990, 990-EZ or 990-PF to provide information on contributions reported on line 1 as revenue from contributors. The general rule requires that organizations that receive \$5,000 or more during the year from any one contributor must complete Schedule B; however, there are special rules that apply to certain organizations exempted under 501(c)(3), (7), (8) or (10). Schedule B is required for 501(c)(3) organizations.
- Schedule C is for 501(c)(3) and 527 organizations filing 990 or 990-EZ to report political campaign or lobbying activities.
- Schedule D is to provide required reporting for donor advised funds, art & museum collections & endowments.
- Schedule E requests information on a private school's non-discriminatory practices and policies.
- Schedule F reports on activities outside the United States by region with the information broken into 3 categories: (1) description of activities; (2) grants to organizations and governments; and (3) grants to individuals.
- Schedule G reports professional fundraising services and events as well as gaming from organizations with more than \$15,000 in fundraising expenses, contributions or gaming income.
- Schedule H gathers information from facilities recognized by a state as a hospital. It has six parts.
- Schedule I reports on grants or other assistance given by an organization to other organizations, governments and individuals in the United States.
- Schedule J is used to report compensation information for certain officers, directors, trustees, key employees (collectively referred to as ODTKEs as

well as the top 5 highest compensated employees or HCEs. W2s and 1099s provide the necessary information to answer the questions.

- Schedule K is used by an organization that reported an outstanding tax-exempt bond issue with an outstanding principal amount in excess of \$100,000 as of the last day of the tax year on a bond issued after December 31, 2002. If the organization has one or more related organizations, the schedule K must be consistent with the filing of the related organization.
- Schedule L gathers information on certain financial transactions or arrangements between the organization and interested persons. It is also used to determine whether a voting member of the organization's governing body is an independent member of the board for purposes of Part VI on Governance, Management and Disclosure.
- Schedule O is used to provide narrative information for responses to specific questions and to explain the organization's operations. There is no Part IV checklist question for Schedule O. Instead, Schedule O is required to be completed by every organization for several Part VI questions and for other questions that require supplementary information.
- Schedule R reports on related organizations, transactions with related organizations and on certain unrelated partnerships through which the organization conducts significant activities.

In the past a missing Schedule A or B has been the most common cause of Form 990 post-filing correspondence from the IRS. The new checklist should help reduce this statistic and instances of incomplete filings that could result in penalties.

## VIII. Federal Tax Compliance Requirements

Part V lists numerous federal tax compliance requirements applicable to organizations. The first six questions apply to all organizations. Questions 7 through 12 apply to some. Completion of this part should alert organizations to their other federal tax reporting obligations and improve compliance in those areas such as W2s and 1096s. Part V also addresses the organization's compliance with regulations related to deductible and non-deductible contributions from donors.

If the organization discovers it has unrelated business income a 990-T filing may be necessary. Part V will also serve as a check on gift solicitation and acknowledgment, personal benefit contracts and foreign accounts. Information is required concerning benefits flowing from the organization to donors, donor advisors and related parties. The benefit to others may take any form. Donor advised funds are those that permit donors who have made contributions to be involved in the organization's decision regarding where the funds are spent and how the funds are used.

## IX. Organizational Structure and Management

### A. Board Structure

Part VI of the new 990 addresses the organizational structure and management of

the nonprofit among other things. Section A deals with the organization's governing body and management. One of the first questions is whether the voting members are "independent." The term "independent" has a specific definition provided by the IRS in the *Glossary of Terms* for the 990 which reads:

"A voting member of the governing body is 'independent' if he or she is (1) uncompensated as an officer, (2) receives less than \$10,000 as an independent contractor,<sup>50</sup> and 3) has no personal contracts or no family member contracts with the organization."<sup>51</sup>

Part VI requests information related to organizational changes such as those made by amendments in the articles of incorporation or bylaws. Question 8 asks whether contemporaneous records in the form of minutes are kept for both the governing body and the committees of the organization. This documentation is essential documentation of approval of the CEO compensation, for good governance generally, and to preserve the institutional memory of the organization.

Providing the 990 to the board before filing encourages accountability on the part of the board of directors. While it is the responsibility of the organization to provide the Board the opportunity to review the 990, it is the responsibility of each board member to review and comment on the information in the 990 prior to filing. Part of a board member's fiduciary obligation is to act in the best interest of the organization.<sup>52</sup>

50. Internal Revenue Service, *Independent Contractor (Self Employed), or Employee*, "The general rule is that an individual is an independent contractor if you, the person for whom the services are performed, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result."

51. This specific definition is not found in the Internal Revenue Code (26 U.S.C.).

52. ARK. CODE ANN. § 4-33-830(a)(3), "A director shall discharge his or her duties as a director, including his or her duties as a member of a committee in a manner the director reasonably believes to be in the best interests of the corporation."

## B. Organizational Policies

Part VI, Section A asks for information regarding policies and practices that are not required by federal tax law. Whether particular policies, procedures, or practices are required depends on the organization's size, type, and culture. Each question applies to a particular time or period within the tax year or for the entire tax year, rather than as of the filing date.

Section B asks if the organization has adopted certain policies that the IRS considers best practices. Sample policies can be found at the website for the Nonprofit Risk Management Center at [www.nonprofitrisk.org](http://www.nonprofitrisk.org).

These policies include a conflict of interest policy, a whistleblower policy or employee protection policy, a policy on document retention and destruction, a policy for determination of executive compensation and a policy dealing with joint ventures. Each of these policies can provide valuable assistance and guidance to the board and officers regarding daily decision making in key areas of governance. Distribution and posting of these policies to board members, officers, members, employees and volunteers can increase the likelihood that the policies will be known and followed.

Organizations can take advice from the IRS about what each policy should include:

The IRS often provides sample forms with preferred language that encourages organizations to adopt policies that will clearly be acceptable if reviewed by the IRS. And, while

adopting the policy is important, the implementation and compliance component is key.

### 1. Conflict of Interest Policy

The conflict of interest policy should define what is meant by "conflict of interest" and identify the categories of persons and entities that are covered by the policy.<sup>53</sup> The policy should facilitate disclosure of information designed to spot potential conflicts of interest and provide a step-by-step process the governing body can follow to resolve the issues.

### 2. Whistleblower Policy

A Whistleblower policy may also be known as an employee protection policy or as an "Anti-Retaliation" Policy. These policies encourage staff and others to come forward with information regarding illegal practices or violations of organizational policy. The policy should clearly identify those to whom such information can be reported in confidence. Safeguards against breaches of confidentiality and protection against retaliation should be built into the process as much as possible.<sup>54</sup>

These policies protect the organization from violations of the law, loss of tax exemption, and scandals that can impact the public image and fund-

53. Internal Revenue Service, Form 1023, *Conflict of Interest Policy*, <http://www.irs.gov/pub/irs-pdf/f1023.pdf> (last visited June 28, 2010).

54. See *supra* note 5 & 6.

raising ability of the organization. The policies are more likely to be successful if the policy is circulated, posted, and incorporated into organizational training. Those who are asked to risk their jobs to come forward must truly believe that the organization's policy is more than mere pretense. Several examples can be found online at no cost.<sup>55</sup>

### 3. Document Retention and Destruction Policy

Historically, the exclusive use of paper in recordkeeping created space limitations that required the destruction of documents at the earliest possible intervals. Today, the need for document destruction can be minimized through the use of digital storage. Organizational documents can be scanned and stored in house, or through the use of cloud computing, documents may be stored remotely online. Before using cloud computing, nonprofits should review any ethical or privacy considerations.<sup>56</sup>

The organization's policy for document retention and destruction should reflect compliance with the IRS requirements and a respect for best prac-

tices. There are policy examples that can be found online at no cost.<sup>57</sup> At a minimum, the organization should retain copies of the 990 returns / notices for the past three years.<sup>58</sup> Articles, by-laws, minutes, and resolutions should be kept for the life of the organization. Other documents should be retained or destroyed in accordance with requirements of any grants or gifts and according to the need for documentation for grant application and fundraising.

### 4. Compensation Policy

One other area subject to scrutiny is the reasonableness of compensation paid by the organization. Policies can be adapted from a template found online.<sup>59</sup> What makes good policy for setting reasonable compensation within the organization? While this subject is covered specifically later in the article in the discussion of Part VII, here are a few key components of organizational policy:

The IRS presumes compensation is reasonable if three conditions are present:

- (1) The compensation is approved in advanced by an autho-

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55. <http://bestpractices.cof.org/files/5E%20-%20Sample%20Whistleblower%20Policy%20-%20NCNA.doc> (last visited June 28, 2010); <http://www.nonprofitrisk.org/library/articles/samplewb.pdf> (last visited June 28, 2010).

56. Richard Acello, *Get Your Head in the Cloud*, ABA JOURNAL, April, 2010, pp.28-29.

57. <http://www.abanet.org/lpm/lpt/articles/sampledecretionpolicy.pdf> (last visited June 28, 2010); <http://managementhelp.org/misc/Sample-Document-Retention-Destruction-Policy.pdf> (last visited June 28, 2010); [http://www.acfe.com/documents/sample-documents/sample\\_document\\_retention\\_policy.pdf](http://www.acfe.com/documents/sample-documents/sample_document_retention_policy.pdf) (last visited June 28, 2010).

58. 2009 Instructions for Form 990, Requirements of a Properly Completed 990, *Record Keeping*, pg 8.

59. <http://www.boardsource.org/Bookstore.asp?Type=epolicy&Item=1038> (last visited June 28, 2010).

rized body. This body may be the board or a committee established for this purpose. The important aspect of the composition of the decision making body is that none of its members have a conflict of interest.

(2) The body should use comparable compensation data for similarly qualified persons in comparable positions at similarly situated organizations *and*

(3) The body should adequately document the basis for its determination through minutes of its meeting at the time the decisions are made.<sup>60</sup>

## 5. Joint Venture Policy

An organization's joint venture policy ensures that any joint venture arrangement furthers the tax exempt purposes and safeguards the organization's exempt status. To that end, all contracts should be at arm's length with reasonable terms; the exempt purposes should be given priority over the investor's profits, and the venture

should take pains to avoid activities that might jeopardize the tax exempt of the organization.

Policies can be adapted from general templates found online.<sup>61</sup> Examples of activities that could jeopardize the organization's exempt status include political campaigning, lobbying, or activities outside the organization's charter or in violation of state law.<sup>62</sup>

## X. Disclosure Obligations

Part VI, Section C deals with the disclosure obligation of the organization. It requires filers to list the states in which the 990 is being filed and describe how the organization makes its documents and financial statements available to the public including who keeps the books.

In Arkansas, Form 990 is filed with the Attorney General.<sup>63</sup> Arkansas filing rules have not changed in that regard.<sup>64</sup> If disclosure is made through a website, the time stamp and contact person should be included.

In Part VI sections B and C the questions elicit information relating to policies and disclosure. Questions related to the public disclosure of documents are separated so

60. Internal Revenue Service, *Tax Exempt Status for Your Organization*, ("Reasonable compensation is the value that would ordinarily be paid for like services by like enterprises under like circumstances."), <http://www.irs.gov/pub/irs-pdf/p557.pdf> (last visited June 28, 2010).

61. [http://www.healthlawyers.org/Members/PracticeGroups/TF/PracticeCorner/Documents/JV\\_Policy.pdf](http://www.healthlawyers.org/Members/PracticeGroups/TF/PracticeCorner/Documents/JV_Policy.pdf) (last visited June 28, 2010).

62. 26 U.S.C. § 501(f), "... exemption from taxation under subsection (a) shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or otherwise attempting, to influence legislation, but only if such organization normally makes lobbying expenditures in excess of the lobbying ceiling amount." Of course, some nonprofits are organized for the purpose of campaigning or lobbying.

63. [http://www.ag.arkansas.gov/consumers\\_protection\\_charitable\\_registration.html](http://www.ag.arkansas.gov/consumers_protection_charitable_registration.html) (last visited June 28, 2010).

64. In Arkansas, only Private Foundations and Public Charities must file their 990 with the Attorney General.

that documents subject to public inspection are listed under Question 18, and those not subject to public inspection requirements are listed in Question 19.

### **XI. Compensation of Independent Contractors, Officers, Directors and Trustees**

Part VII Sec. B requires the listing of compensation of the top five highest paid independent contractors that received more than \$100,000 from the organization. An "independent contractor" is any person or entity that is paid for work and not treated as an "employee."<sup>65</sup>

A listing of the organization's current officers, directors and trustees, is required regardless of whether they are compensated. The 990 also calls for information on the organization's top twenty highest paid key employees who received over \$150,000 and its top five other highest compensated employees who received over \$1,000, as well as certain persons who had served in such capacities in the previous five years. In addition, it requires information on compensation paid such persons by the organization or by a related organization. Schedule J-2 may be used

for this purpose if additional space is needed. "Reportable compensation" is compensation reported on W-2 box 5 or box 1, or Form 1099-MISC box 7.<sup>66</sup>

### **XII. Financial Information and Accounting Procedures**

Parts VIII and IX call for a listing of revenues and expenses. These two parts of the 990 are essentially the income statement portion of the form. The revenue listing in Part VIII should include all contributions, gifts, grants, dues, non-cash contributions, program service revenue.

Part IX provides for expenses and the categories should more closely parallel normal accounting expense items. This Part allows donors to see organizational efficiency in the use of revenues.

Part X is not new. It is essentially the balance sheet for the organization. Assets, liabilities and net assets or fund balances are reported here from the organization's books.

Part XI is new and is used to report the organization's method of accounting and other information regarding its compiled, reviewed or audited financial statements. An outside audit is preferable. This part asks whether

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65. See *supra* note 50.

66. Form 990, Part VII and Schedule J- *Reporting Executive Compensation, Meaning of "Reportable Compensation" and "Other Compensation,"* [www.irs.gov/charities/article/0,,id=206654,00.html](http://www.irs.gov/charities/article/0,,id=206654,00.html) (last visited June 28, 2010).



the organization is required to undergo an audit under the Single Audit Act or OMB circular A-133. The organization will probably answer "yes" if the organization received a federal award.

### Conclusion

Just prior to going to print, the IRS released information on one-time filing relief for Form 990-N and 990-EZ filers at risk of losing their tax exempt status because they have not filed for three consecutive years. The one-time relief is available only to small organizations whose filing deadlines are after May 17, 2010 and prior to October 15, 2010.<sup>67</sup>

Nonprofit organizations mandated to file Form 990 or Form 990-PF are not eligible for the one-time relief and will be automatically revoked if they fail to file for three consecutive years.

The time to take advantage of the transition period has passed for some organizations, but for others it is not too late to comply with the new requirements. Counsel representing nonprofits should take advantage of the opportunity to review the materials available at the Nonprofit Risk Management Center and meet with board of directors, review existing organizational policy, and speak with staff. It is the author's hope that the information provided by this article about the requirements related to the 990 and the resources that are available will serve to assist attorneys and other professionals in the preservation of the tax exempt status of nonprofit organizations.

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67. *See supra*, note 3.