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CLIENT MEMORANDUM

Changes to 2008 IRS Form 990 and Instructions

October 14, 2008

The Internal Revenue Service (the "IRS") recently released a redesigned 2008 Form 990 (the "2008 Form 990"), as well as related instructions (the "Instructions") for organizations exempt from income taxation under Section 501(c)[1]. The Form 990 is used by Section 501(c)(3) organizations that are classified as public charities, but not those classified as private foundations, which must file the Form 990-PF.

An organization that currently files the Form 990 will be required to complete the redesigned 2008 Form 990 for its taxable year which begins on or after January 1, 2008. For example, if an organization's taxable year begins on January 1, the organization will need to begin filing the 2008 Form 990 for its taxable year beginning January 1, 2008 and ending December 31, 2008, which means the organization's first filing using the 2008 Form 990 will be due (without taking into account any extensions) by May 15, 2009.

This memorandum highlights some of the key changes to the 2008 Form 990 and Instructions. It does not contain guidance as to how to complete the 2008 Form 990. We recommend that you consult with your advisors for further guidance regarding the 2008 Form 990.

I. BACKGROUND

The Form 990 had not been materially redesigned since 1979. The recently revised 2008 Form 990 includes significant changes in both form and substance. The IRS has explained the need for these changes as, specifically, the need to: (i) address changes in the law; (ii) clarify questions in the form and instructions to address common questions and/or complaints; (iii) improve the logical sequential flow of the form; and (iv) improve the overall scope of materials presented to provide an accurate summary of the filing organization's activities.
This revision reflects the IRS's view that

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[1] All section references are to the Internal Revenue Code of 1986, as amended. Generally, organizations exempt under Sections 572 or 4974(a) must also complete the Form 990.

the Form 990 has served increasingly as both a means of regulation, as well as a means of providing public information. The IRS intends that the major revisions to the 2008 Form 990 will improve transparency and compliance in the tax-exempt sector and, at the same time, minimize the reporting burden on tax-exempt organizations.

II. TRANSITIONAL RELIEF

The IRS has implemented a graduated transition period to ease the burden of the increased reporting requirements contained in the 2008 Form 990 on certain smaller organizations. Specifically, the IRS has broadened the category of organizations that are permitted to complete the Form 990-EZ, the Short Form Return of an Organization Exempt from Income Tax, instead of the Form 990. While the Form 990-EZ has not been redesigned for the 2008 taxable year, certain organizations filing the 2008 Form 990-EZ may be required to complete some schedules from the 2008 Form 990.

In the 2008 taxable year, most filing organizations that have: (i) between $25,000 and $1 million in gross receipts and (ii) total assets of less than $2.5 million may file the Form 990-EZ. These levels have been changed from their 2007 amounts, which were less than $100,000 in gross receipts and less than $250,000 in total assets.

In the 2009 taxable year, most filing organizations that have: (i) gross receipts between $25,000 and $500,000 and (ii) less than $1.25 million in total assets may file the Form 990-EZ.

Finally, in the 2010 taxable year, and permanently thereafter, most filing organizations that have: (i) gross receipts between $50,000 and $200,000 and (ii) total assets of less than $500,000 may file the Form 990-EZ.

Organizations that have gross receipts that are normally $25,000 or less will still generally be required to file the Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ.[2]

III. HIGHLIGHTS OF THE CHANGES TO THE 2008 FORM 990

A. Layout and Composition

The 2008 Form 990 consists of an eleven-page core form and sixteen schedules, all of which focus on the activities of the filing organization. In contrast, the 2007 IRS Form 990 consisted of a nine-page core form and two schedules (Schedule A (*Public Charity Status*) and Schedule B (*Contributors*)).

In the interest of increasing clarity and conformity, in Part I (*Summary*) of the core form, the IRS requires the filing organization to provide a snapshot of information required elsewhere in the 2008 Form 990. This information includes the filing organization's mission, activities, and current and prior years' financial results. In Part IV (*Checklist of Required Schedules*) of the core form, the IRS requires filing organizations to complete a checklist to determine which schedules the filing organization must complete and file with the IRS.

In general, the sixteen schedules focus on particular areas of interest to the IRS and to the public. In addition to improving the clarity of required reporting, the revised schedules aim to standardize the information reported by filers. Generally, filers must complete Schedules A (*Public Charity Status*), B (*Contributors*) and D (*Supplemental Financial Statements*). A filing organization may be required to complete additional schedules depending on whether the filing organization engages in activities covered by the particular schedule.

B. Governance

One area of reporting that has been significantly changed in the 2008 Form 990 is governance. Specifically, Part VI (*Governance, Management and Disclosure*) of the core form

[2] Presumably, this gross receipts limit will increase to $50,000 in 2010.

requires the filing organization to disclose information about the organization's governing body and management, policies, disclosure practices, and the means by which it will make governance and financial information publicly available.

Notably, many of the questions relating to governance request information about practices or policies that are not required by federal tax law. These questions appear to represent particular areas of focus for the IRS and behavior modification suggestions that the IRS would like to encourage filing organizations to implement.

1. Policies

One set of questions covers whether the filing organization has adopted certain policies. Examples of such questions in Part VI include questions about whether the filing organization has instituted written policies with respect to: (1) conflicts of interest; (2) whistleblower protection; (3) document retention and destruction; (4) compensation; and (5) joint ventures. Again, while there is no federal tax law requirement that an organization adopt such policies, a filing organization should consult with its own advisors as to whether or not it should institute such policies.

Additional disclosure regarding governance is also required by certain schedules. For example, certain schedules require grantmaking organizations to report, among other things, whether the organization maintains records to substantiate the amount of its grants, grantees' eligibility, selection and monitoring procedures. Also, Schedule M (*Non-Cash Contributions*), which requires a filing organization to disclose certain information about its non-cash contributions, requires the filing organization to disclose whether it has a gift acceptance policy that requires review of non-standard contributions.

2. Processes

Another area that the IRS appears focused on is whether the filing organization follows certain processes. Specifically, the governance section requires disclosure of whether the filing organization contemporaneously records minutes of all meetings of its governing body and each committee with authority to act on behalf of its governing body. The Instructions make clear that the filing organization must have contemporaneously recorded the minutes of every meeting in the year in order to answer "Yes." If a filing organization has not done so, the filing organization must provide an explanation.

The 2008 Form 990 also requires disclosure of whether the 2008 Form 990 itself has been reviewed by the filing organization's full governing body before it was filed, and the process of review.

The 2008 Form 990 also asks governance-related questions with respect to compensation processes and practices including whether the organization has a process for the determination and approval of the compensation paid to certain officers and key employees.

C. Compensation

The 2008 Form 990 requires enhanced reporting about compensation practices. Specifically, Part VII (*Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors*) requires that the filing organization report compensation information for the following categories of individuals: (i) current directors, officers and "key employees," regardless of the amount of compensation received annually; (ii) current highest-compensated employees (other than directors, officers and key employees) who receive more than $100,000 in compensation annually from the filing organization and any related organization; (iii) certain former directors who receive more than $10,000 in compensation annually from the filing organization and any related organization; and (iv) certain former officers, key employees or highest-compensated employees who receive more than $100,000 in compensation annually from the filing organization and any related organization (in each case, "former" includes individuals who have served in such a capacity during the filing organization's five prior taxable years).

1. Key Employees

The definition of a "key employee" has been clarified. The instructions to the 2007 Form 990 defined a "key employee" as any person who has responsibilities, powers, or influence similar to those of officers, directors or trustees. In contrast, a "key employee" is defined in the 2008 Instructions as any employee of the filing organization (other than an officer or director) who:

(i) receives compensation of more than $150,000 from the filing organization and any related organization for the calendar year ending with the filing organization's taxable year; and

(ii) (a) has responsibilities, powers or influence over the filing organization as a whole that is similar to those of officers or directors;

(b) manages a discrete segment or activity of the filing organization that represents 10 percent or more of the filing organization's total activities, assets, income or expenses; or

(c) has or shares authority to control or determine 10 percent or more of the filing organization's capital expenditures, operating budget or compensation for employees.

The filing organization needs to report compensation only for its top twenty (ranked by compensation) key employees. If the filing organization has additional "key employees," the top five (ranked by compensation) of these additional "key employees" may be considered to be part or all of the filing organization's top five highest-compensated employees.

2. Related Organizations

The definition of a "related organization" has been clarified from the definition provided in the 2007 Form 990 and related instructions. The 2007 Form 990 defined a "related organization" in terms of six different relationships. The 2008 Form 990 eliminates the six different relationships and defines a "related organization" as follows: (i) an organization that controls the filing organization; (ii) an organization which the filing organization controls; (iii) an organization controlled by the same individuals who control the filing organization; and (iv) an organization that is (or claims to be) at any time during the organization's taxable year (a) a supporting organization (within the meaning of Section 509(a)(3)) of the filing organization, if the organization is a supported organization (within the meaning of Section 509(f)(3)), or (b) a supported organization, if the filing organization is a supporting organization.

In the context of a not-for-profit or other organization without stock, control means either: (i) a management or board overlap pursuant to which a majority of the not-for-profit organization's directors are also directors, officers, employees or agents of the other organization, or (ii) one organization's ability to appoint or elect a majority of the members of the governing board of the not-for-profit organization.

In the context of a for-profit or other organization with stock or other economic interests, control means ownership of more than 50% of the stock (by voting power or value) of a corporation, or ownership of more than 50% of the profits or capital interest in a partnership or limited liability company. Control may also be established through indirect relationships (*e.g.*, through multiple controlled corporations, partnerships or limited liability companies).

Disclosure of transactions with related organizations is required by Schedule R (*Related Organizations and Unrelated Partnerships*). Schedule R requires the filing organization to provide information about transactions with related organizations and certain unrelated partnerships such as sales or purchases of assets, leases of facilities or equipment, performance of services, sharing of facilities, equipment or other assets, sharing of paid employees, etc.

3. Independent Contractors

Part VII also requires that the filing organization report compensation information for its top five highest-compensated independent contractors (*i.e.*, those that received more than $100,000 from the filing organization annually, raised from $50,000 on the 2007 Form 990).

4. Compensation Processes

As noted above, Part VI requires the filing organization to report information about certain compensation processes. Specifically, Section B (*Policies*) of Part VI requires that the filing organization disclose whether the filing organization's process for determining the compensation of its CEO or Executive Director and other officers and key employees includes a review and approval of that compensation by independent persons who rely on comparability data and contemporaneously substantiate their deliberation and decision, and requires that the filing organization describe its process for determining the compensation of its CEO or Executive Director and other officers and key employees.

5. Schedule J

More detailed compensation reporting is required by Schedule J (*Compensation Information*) of the 2008 Form 990. Among other things, Line 5 of Part VII of the core form generally requires that if a person receives or accrues compensation from an unrelated organization for services rendered to the filing organization in the person's capacity as an officer, director, trustee, or employee of the filing organization, the name of the unrelated organization, the type and amount of compensation it paid or accrued, and the person receiving or accruing such compensation must be reported on Schedule J if the filing organization has knowledge of the compensation arrangement.

In addition, Schedule J requires a filing organization to disclose whether the filing organization provides the following categories of benefits to any of the individuals covered by Schedule J, whether the filing organization has a written policy regarding provision of these benefits and whether the filing organization requires that the related expenses be substantiated before they are paid or reimbursed: (i) first-class or charter travel; (ii) travel for companions; (iii) tax indemnification and gross-up payments; (iv) discretionary spending accounts; (v) housing allowances or residences for personal use; (vi) payments for business use of personal residence; (vii) health or social club dues or initiation fees; and (viii) personal services (e.g., maid, chauffeur, chef).

D. Miscellaneous Highlights

- Schedule A (*Public Charity Status*) of the 2008 Form 990 focuses on the filing organization's public charity status and public support. In reporting all amounts on Schedule A, the filing organization must now use the same method of accounting that the organization used to complete its financial statements and reporting. In contrast, the support schedule in Schedule A of the 2007 IRS Form 990 had to be completed using the cash method of accounting. In addition, the support schedule in the new Schedule A of the 2008 Form 990 increases the computation period from four to five years, including the current taxable year and the four preceding taxable years.
- Schedule D (*Supplemental Financial Statements*) is new and requires, among other items, supplemental disclosure about certain financial information. Schedule D may also be required to be completed by conservation organizations, museums and other organizations maintaining collections, credit counseling organizations and others holding funds in escrow or custodial arrangements, and organizations maintaining endowments or donor advised funds and similar funds or accounts. Examples of some of the types of information required by Schedule D include: (1) financial information regarding endowment funds over a five-year period (including the current filing year and the four prior years); (2) if a filing organization has collections, they may be required to include a description of the collections and explain how the collections further the organization's exempt purposes;

and (3) financial information and information about certain written policies of donor advised funds.

- Schedule F (*Statement of Activities Outside the United States*) is new and requires reporting of the filing organization's activities (including grants or assistance made to foreign organizations, governments and individuals) conducted outside the United States. Filing organizations that are required to complete Schedule F are required to report their operations by geographic regions.
- Schedule H (*Hospitals*) is new and must be completed by a filing organization that operates one or more facilities licensed or registered as a hospital under state law. Questions on Schedule H focus on charity care and community benefits, among other topics.
- Schedule L (*Transactions with Interested Persons*) of the 2008 Form 990 requires a filing organization to describe certain transactions with interested persons. The disclosures required by Schedule L are not significantly different from those which were previously required on prior versions of the Form 990.
- Schedule M (*Non-Cash Contributions*) is used to report non-cash contributions (excluding donations of services or the use of facilities) received by the filing organization as well as to provide certain information regarding such contributions. Specifically, Schedule M requires reporting of the quantity and reported financial statement amount of non-cash contributions received by type of property (including any non-cash donated items that were sold immediately after received). Schedule M also requires museums and other filing organizations maintaining collections to complete Schedule M for contributions even if they do not report revenue for such contributions. As noted above, Schedule M also asks whether or not a filing organization has a gift acceptance policy that requires review of non-standard contributions.

IV. CONCLUSION

Organizations required to file the 2008 Form 990 should already be preparing any new data collection procedures that may be necessary to prepare the 2008 Form 990. Filing organizations should also consider whether they wish to implement additional policies and procedures, such as those discussed above on Page 3, so that they can give favorable answers to the new questions contained in the 2008 Form 990.

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