



Challenges Reflected by the New Form 990 for Exempt Organizations

Gary J. McRay

Foster Swift Health Care Law E-News

April 7, 2009

Most exempt organizations must file an annual return (Form 990, Form 990-PF or Form 990-EZ) or an annual electronic notice (Form 990-N) depending on the organization's gross receipts and total assets. In December of 2007, the IRS issued its redesigned Form 990, for years beginning in 2008, and then issued temporary and final regulations to implement the redesigned Form 990 on September 9, 2008. For the last twenty-five years, Form 990 has been a fairly simple document, emphasizing financial information. The new 2008 Form 990 is 11 pages with up to 16 schedules and hundreds of pages of instructions. The IRS views this new form as its primary source of information concerning exempt organizations. Not only is it important to properly convey the extensive information found on Form 990 to the IRS to protect the organization's federal tax exemption, but since Form 990, including its schedules and attachments, is available for public inspection, including review by competitors and even tax whistleblowers, it is an important public relations document. The questions and information solicited by the IRS, although not specifically required by existing tax law, create "best practices" that the IRS will use to judge compliance with community benefit standards.

DISCLOSURE TO BOARD OF DIRECTORS

Even though federal tax law does not require an exempt organization's board of directors to specifically review the Form 990 and its information, Part VI, Line 10 indicates that the IRS believes this disclosure to the governing board prior to filing is important. In addition to disclosure before filing, the exempt organization must describe the process on Schedule O that the exempt organization uses to review Form 990 with its board of directors. Although not technically mandated by federal tax law, most health lawyers will recommend that the exempt organization review the Form 990 with its board before filing. The public has been able to obtain copies of the exempt organization's Form 990 for many years, pursuant to IRS Code Section 6104(d). Now, the organization will need to describe on Schedule O

CONTACT

Gary J. McRay

P: 517.371.8285

E: gmcray@fosterswift.com

AUTHORS/ CONTRIBUTORS

Gary J. McRay

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how it makes its governing documents, conflict of interest policy and financial statements available to the public and whether the public may inspect the Form 990 upon request or through a website.

COMMUNITY BOARD OF DIRECTORS

One criterion of obtaining a tax exemption is that a majority of the members of the governing board be independent community members. (Rev. Rul 69-545). The IRS now wants disclosure on Form 990 of the size of the board and how many board members are independent. The IRS considers a board member independent only if:

1. The board member was not compensated as an officer or employee of the organization or of a related organization, except as provided in a narrow religious exception;
2. The board member did not receive total compensation or other payments exceeding \$10,000 during the organization's tax year from the exempt organization or from a related organization as an independent contractor, other than reimbursement of expenses under an accountable plan or reasonable compensation for services provided in his or her capacity as a member of the governing body; and
3. Neither the member nor any family member of the board member was involved in a transaction with the exempt organization either directly or indirectly, that must be reported on Schedule L. (For example, loans, grants or transactions greater than certain financial limits are reportable.)

Physicians who serve on a hospital's board of directors who are employed as medical directors or who receive compensation greater than \$10,000 from the hospital for services rendered as an independent contractor will not be considered to be independent.

REQUIRED POLICIES

Hospitals have adopted and used "charity care policies" for many years to demonstrate their mission of providing free or discounted care for those who financially qualify for such benefits. Schedule H, Part I solicits the confirmation and terms of this written policy.

In addition, Part VI, Section B of the Form 990 has a series of questions that probe whether or not the organization has certain additional policies which the IRS believes are important to demonstrate its concept of best practices by a charity. Although there is no specific requirement that any of these policies exist in order for an organization to obtain or keep its exemption, the IRS clearly wants to see policies in the following areas:

1. a written conflict of interest policy that encourages annual conflict of interest disclosures by officers, directors and key employees and describes the steps the organization takes to regularly monitor and enforce compliance with the policy;
2. a written whistleblower policy;
3. a written document retention and destruction policy;
4. a written compensation policy; and



5. a written policy concerning how an organization evaluates its participation in joint venture arrangements and the steps taken to safeguard the organization's exempt status.

Exempt organizations have had conflict of interest policies ever since the 1997 CPE Text recommended such. Most exempt organizations have an annual disclosure process to track conflicts and periodically require compliance with their adopted policy. Likewise, many hospitals and other exempt organizations have developed whistleblower policies in order to comply with the Deficit Reduction Act of 2005 and the federal Civil False Claims Act and applicable state false claims acts, all of which prohibit retaliation. A whistleblower policy is typically part of a corporate compliance policy to encourage employees and others to come forward with information concerning potential illegal practices or violations of the organization's policy concerning corporate compliance and lawful activity. This policy protects the individual from retaliation by the organization and identifies how a person would report a potential violation.

The Form 990's compensation policy referenced in Part VI, line 15, would typically be found in the hospital's policy that implements compliance with the Taxpayer Bill of Rights II involving compensation arrangements and business transactions with disqualified persons. This policy typically requires, in order for the organization to maintain the rebuttable presumption of reasonableness: (i) a disinterested governing body or committee to approve compensation packages involving the CEO, other officers and other disqualified persons, (ii) the reviewing committee to obtain and rely upon appropriate data as to comparable compensation for similarly qualified persons in comparable positions at similarly situated organizations, and (iii) adequate documentation of the basis for its determination used concurrently with making the determination. There are no surprises here except Schedule J requires more detail on what was used by the hospital to establish the CEO's compensation.

Having a document retention policy is wise from a business point of view, and most large organizations both exempt and taxable have such a policy, or should, now that the IRS is requesting evidence of such in Form 990.

Many hospitals have outpatient ambulatory surgery centers or other diagnostic clinics owned jointly with physicians or other non-exempt entities. If so, the IRS wants to see the written policy that causes the hospital to evaluate its participation under applicable federal tax law and otherwise safeguards the organization's exempt status. The IRS wants any joint venture (J/V) policy to consider the following safeguards:

1. the hospital has control over the J/V sufficient to ensure that the J/V furthers the exempt purpose of the hospital;
2. the J/V must give priority to the exempt purposes of the hospital over maximizing profits for the other taxable participants;
3. the J/V does not engage in activities that would jeopardize the hospital's tax exemption (such as political intervention or substantial lobbying); and
4. all contracts entered into with the J/V and all payments to the taxable entities are on terms that are at arm's length and at fair market value.



In addition to encouraging new policies, Form 990 demands extensive disclosure concerning compensation of officers, directors and key employees. Now disclosure is mandated not only for base compensation, bonuses, incentives, severance, but also travel, moving expenses, taxable meals and entertainment, social club dues, taxable spending accounts, all in more detail than ever before. See Schedules J and L. Plus, there is disclosure concerning tax-exempt bonds (see Schedule K) which becomes more extensive in 2009.

Not only will Form 990 be more of a challenge for management to accurately prepare, but it is now a more detailed set of information used by exempt organizations to promote their charitable works and missions and also used by the IRS to select audit candidates for exemption status challenges. The information conveyed to the IRS and the public in a hospital's Form 990 is no longer a document only reviewed by the hospital's accountants. It now is the justification of why the hospital should continue to be exempt from taxation.

