

# IRS Form 990 Updates: How Much More Will Your Organization Need to Disclose about Compensation in 2009?

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# ▪ Agenda

- **Overview and Timeline of Changes**
- **History and Backdrop**
- **Structural Changes**
- **New Governance Provisions (Part VI)**
- **New Compensation Disclosures (Part VII)**
- **Schedule J**
- **Implementation and Effective Dates**
- **What should you do now?**

## ■ Overview and Timeline of Changes

- Form 990
  - Informational return for tax exempts
  - Reports income, expenses, assets, liabilities and other information
  - Most states rely on the forms for oversight
  - Only “publicly” available information for media, research, potential donors
- 2008 overhaul is first major revision to Form 990 since 1979
  - Enhances transparency
    - » Realistic picture of exempt organization
    - » Basis for comparing the organization to similar organizations
  - Promotes tax compliance
    - » Staying within exempt purpose
    - » Appropriate use of assets
  - Minimizes burden on filing organizations (?)
- Proposed Rules Issued in June, 2007
  - Parallels SEC’s transparency goals for public company compensation disclosure
- Final Rules Communicated December, 2007
- Effective for 2008 Tax Year
  - Decisions and payments made now subject to new reporting rules

## History and Backdrop

- **Congress enacts IRC 4958 in 1996 (Final Regs in 2002): Intermediate sanction on excess benefit transactions**
  - “Disqualified person” receives an improper personal gain from the exempt organization
  - Three-part compensation test:
    - » Independent governing body
    - » Reliance on comparable data
    - » Adequate documentation
  - Results in excise tax against individual (25-200%) and organization manager (10%)
  - Service cannot revoke tax exempt status

## History and Backdrop (con'd)

- **Executive Compensation Compliance Initiative implemented by IRS in 2004, with results published in 2007**
  - Many organizations confused and did not understand instructions
  - Significant errors and omissions in compensation reporting
  - \$21 million in excise taxes assessed for excess benefit transactions
    - » Excessive salary and incentive compensation
    - » Unreported payments for vacation homes, personal legal fees, or personal auto
    - » Unreported payments for personal meals and gifts to others on behalf of the disqualified person
    - » Payments to an officer's for-profit corporation in excess of the value of services provided to the corporation
    - » Loans with favorable rates or total forgiveness

## ▪ History and Backdrop (con'd)

- **Government Accountability Office and Senate Finance Committee**
- **Scandals and news in tax-exempt community**
  - CareFirst BCBS
  - United Way of Central Carolinas
  - Smithsonian Institution
  - University of California
- **SEC revamped executive compensation disclosure of public companies in 2006**
- **Sarbanes-Oxley**
- **Bailout legislation**

# ■ Structural Changes

## ■ Old Form

- 9 pages, 2 schedules, 36 potential attachments
- Compensation: Compensation paid, benefits, expense accounts

## ■ New Form

- **“Core Form”** – for all organizations
  - » Part I: Summary
    - Allows the organization to tell its story up front, with a snapshot of financial, governance and operations information, including a 2-year comparison of key financial data
  - » Part II: Signature Block
  - » Part III: Statement of Program Service Accomplishments
  - » Part IV: Checklist of Required Schedules
  - » Part V: Statements Regarding Other IRS Filings and Tax Compliance
  - » **Part VI: Governance, Management and Disclosure**
  - » **Part VII: Compensation to Officers, Directors, Trustees, Key Employees, HCEs and ICs**
  - » Part VIII Statement of Revenue
  - » Part IX: Statement of Functional Expenses
  - » Part X: Balance Sheet
  - » Part XI: Financial Statements and Reporting

## ▪ Structural Changes (con'd)

- **16 Schedules** – As appropriate
  - » Schedule A: Public Charity Status and Public Support
  - » Schedule B: Schedule of Contributors (no change)
  - » Schedule C: Political Campaign and Lobbying Activities
  - » Schedule D: Supplemental Financial Statements
  - » Schedule F: State of Activities outside of U.S.
  - » Schedule E: Schools
  - » Schedule G: Supplemental Information Regarding Fundraising or Gaming Activities
  - » Schedule H: Hospitals
  - » Schedule I: Grants and Other Assistance to Organizations, Governments and Individuals in the U.S.
  - » **Schedule J: Compensation Information**
  - » Schedule K: Supplemental Information on Tax Exempt Bonds
  - » Schedule L: Transactions with Interested Persons
  - » Schedule M: Non-Cash Contributions
  - » Schedule N: Liquidation, Termination, Dissolution or Significant Disposition of Assets
  - » Schedule O: Supplemental Information to Form 990
  - » Schedule R: Related Organizations and Unrelated Partnerships

## ■ New Governance Provisions (Part VI)

- **IRC cannot require governance, management or disclosure policies**

- But absence of policies could lead to opportunities for excess benefit transactions

- **Three Sections**

- Governing body and management
- Disclosure
- Policies
  - » Compensation-setting process: Disclose if the company has a process for determining compensation that includes:
    - Review and approval of a governing body or compensation committee (that excludes interested parties)
    - Use of data as to comparable compensation for similarly qualified persons in functionally comparable positions at similarly situated organizations, and
    - Contemporaneous documentation and recordkeeping for decisions
  - » Process question applies to CEO, Executive Director, top management, or other officers or key employees
  - » If yes, provide description of the process and dates of process in Schedule O

## ▪ New Compensation Disclosures (Part VII)

- **Must populate chart that includes:**
  - Name and title
  - Average hours per week
  - Positions
  - Reportable compensation from the organization
  - Reportable compensation from related organizations
  - “Other” compensation
- **The following positions must be included:**
  - Current “**officers**”, directors, trustees and “**key employees**”
  - Current top five “**HCEs**” (other than above) > \$100,000 in compensation
  - Former officers, key employees and HCEs who received current compensation of > \$100,000
  - Former directors or trustees who receive current compensation of > \$10,000

# New Compensation Disclosures (Part VII) (con'd)

## ▪ **Officer**

- Manager of daily operations, such as president, VP, secretary, treasurer, top financial officer and top management officer.

## ▪ **Key Employee – must meet 3-part test:**

- \$150,000 Test: Reportable compensation > \$150,000
- Responsibility Test:
  - » Has responsibility over organization as a whole
  - » Manages a discrete segment that represents 10% of organization, or
  - » Has authority to control or determine 10% of budget
- Top 20 Test: Is one of the 20 employees with highest reportable compensation for the organization and related organizations

# New Compensation Disclosures (Part VII) (con'd)

- **What compensation is being reported?**
  - W-2 and 1099
  - Other compensation
    - » Employer contributions to qualified DC plan
    - » Annual increase in actuarial value of qualified pension plan (whether or not funded or vested)
    - » Value of health benefits
    - » Tax-deferred contributions by the employer and employee to non-qualified defined contribution plan (whether or not funded or vested or subject to SRF)
    - » Annual increase in actuarial value of a non-qualified pension plan (whether or not funded or vested or subject to SRF)
    - » \$10,000 exception

## New Compensation Disclosures (Part VII) (con't)

- **Independent Contractors have a separate table**
  - Must provide name and business address, description of services, compensation for the five most highly paid independent contractors that received > \$100,000 of compensation from the organization
  - Must also provide total number of ICs who receive more than \$100,000 in compensation from the organization

## ■ What Triggers Schedule J?

- Former officers, key employees, or HCEs who received current compensation > \$100,000
- Former directors who received current compensation > \$10,000
- Anyone listed whose reportable compensation + other compensation > \$150,000
  - **All key employees**
  - **Current directors, officers if total compensation > \$150,000**
  - **Current HCEs if total compensation > \$150,000**

# Schedule J Disclosure – All reported individuals in Core Form (except ICs)

- **Perquisite disclosure**
  - First class or charter travel
  - Companion travel
  - Tax indemnification and gross ups
  - Discretionary spending accounts
  - Housing allowances
  - Payments for business use of personal residence
  - Health or social club dues
  - Personal services (maid, chauffeur, chef)
- **Written policies and substantiation**
- **Compensation process and arrangements**
  - Compensation committee
  - Independent Compensation Consultant
  - Form 990s
  - Written employment agreements
  - Surveys
  - Approval of Board or compensation committee
- **Termination payment disclosure**
  - Severance or CIC
  - SERP payouts
  - Equity benefits
- **Compensation contingent on the organization's revenue or net earnings**

# Schedule J Disclosure – “Triggering Individuals” only

## Detailed Quantification in Tabular Format on Schedule J

Name	Base	Bonus & Incentive Compensation	Other Compensation	Deferred Compensation	Nontaxable Benefits	Total	Prior Form 990 Compensation
Executive A							
Executive B							
Executive C							
Executive D							

## ■ Implementation and Effective Dates

- **Revised Form 990 for 2008 tax year**
- **3-Year Transition Rule for smaller exempt organizations that use Form 990-EZ**
  - 2008 tax year:
    - » Gross receipts between \$25,000 and \$1M, and
    - » Total assets at year end less than \$2.5M
  - 2009 tax year:
    - » Gross receipts between \$25,000 and \$500,000, and
    - » Total assets less than \$1.5M
  - 2010 and later:
    - » Gross receipts between \$50,000 and \$200,000 and
    - » Total assets less than \$500,000
- **Form 990-N**
  - Companies with gross receipts less than \$25,000
  - Postcard identifies organization and indicates justification for not filing a return

## ▪ Checklist for Initial Filing

- **Create a mock-up of Core Form and Schedule J**
- **Identify other potential Schedules**
- **Strengthen the Board's processes**
- **Identify officers, directors, trustees and potential key employees and top 5 highest compensated employees**
- **Educate them as to the breadth of disclosure**
- **Review perquisites and perquisite policies**
- **Review CIC and severance arrangements**
- **Review the governance questions**
- **Answer "why"**