

## IRS Releases Final Instructions for New Form 990

On August 19, 2008, the IRS announced that it had completed its revision of the [instructions](#) for the 2008 Form 990 (Return of Organization Exempt from Income Tax). The instructions were finalized after reviewing public comments received on draft instructions released in April. Although the instructions are marked “draft” pending final formatting late in 2008, no further significant changes in content are anticipated.

These instructions complete the package for a substantially revised Form 990, to be filed for tax years beginning in 2008. The first major revision of the Form 990 since 1979, the new form (released in December 2007) replaces a nine-page form and two schedules with an 11-page “core” form and 16 schedules. The form reflects the IRS’s current focus on compensation and governance issues, and requests substantially more information in several areas, including tax-exempt bonds, hospitals, charitable gifts and international activities.

The final instructions are significant because they clarify the scope of many questions on the form. This alert highlights several points of particular interest.

### Key Employee Definition Narrowed

The IRS has limited somewhat the significantly expanded definition of “key employee” contained in the draft instructions. The final instructions require compensation disclosure for an employee other than an officer, director or trustee if the employee: (1) receives more than \$150,000 in compensation during the calendar year from the organization and related organizations (the “\$150,000 test”); (2) has responsibilities similar to those of an officer, director or trustee; manages a discrete part of the organization that accounts for 10% or more of the organization’s activities, assets, income or expenses; or has authority to control or determine 10% or more of the organization’s capital expenditures, operating budget or compensation (the “responsibility test”); and (3) is one of the top 20 highest compensated employees who satisfy both the \$150,000 test and the responsibility test.

### Increased Reporting Thresholds for Business Transactions with Interested Persons

Schedule L requires reporting of certain business transactions between the organization and “interested persons” (including current and former officers, directors, trustees, key employees, their family members and affiliated entities). The draft instructions proposed a \$10,000-per-transaction threshold for reporting such transactions. The final instructions generally increase the threshold, requiring reporting if all payments between the organization and the interested person during the tax year exceeded \$100,000, or if all payments between the parties during the tax year from a single transaction exceeded the greater of \$10,000 or 1% of the organization’s total revenues.

### Modified Standard for Independent Voting Members

The new form requires organizations to report how many voting members of the governing body are “independent.” Voting members are considered to lack independence if they are compensated as officers or employees, or receive more than \$10,000 annually as independent contractors. The draft instructions proposed that a voting member would also lack

independence if he or she received a “material financial benefit” from the organization. The IRS deleted the material financial benefit standard from the final instructions. Instead, a voting member will be considered to lack independence if the member (or a family member) is involved in a transaction with the organization or a related organization that would be reported on Schedule L (Transactions with Interested Persons).

### **Business Relationships Among Officers, Directors, Trustees and Key Employees**

Like the 2007 Form 990, the new form requires organizations to report business relationships among insiders. The broad definition of “business relationship” in the draft instructions has been narrowed to exclude business transactions in the ordinary course of either party’s business on the same terms as generally offered to the public. In addition, the threshold for reporting business transactions has been increased from \$5,000 to \$10,000.

### **Reasonable Efforts Standard for Obtaining Information from Trustees, Officers and Others**

The final instructions state that organizations are required to engage in no more than a “reasonable effort” to obtain the information necessary to answer certain questions on the form, including those related to director/trustee independence, business and family relationships among insiders, compensation paid by related organizations and business transactions between the organization and interested persons. The instructions suggest that reasonable effort may involve distributing an annual questionnaire designed to gather the information required by the form.

### **Governing Body Review of Form 990**

The new form asks whether a copy of the Form 990 was provided to the organization’s governing body, and for a description of the review process. The final instructions clarify that this question may be answered affirmatively if, for example, each board member is sent the form by e-mail before it was filed, even if no board member ever reviewed the form. However, the review process (or lack thereof) must still be described.

### **Changes in Deferred Compensation Reporting**

Although the IRS requested comments on whether deferred compensation should be subject to reporting prior to vesting, the final instructions retain the requirement that compensation earned or accrued in, or attributable to, one year, and deferred to a future year, must be reported on Schedule J, whether or not funded, vested or subject to a substantial risk of forfeiture. The final instructions state that the annual increase in the actuarial value of a defined benefit plan must be reported as deferred compensation (using a reasonable estimate if actual numbers are not available), but that earnings accrued on deferred amounts in a defined contribution plan need not be reported.

### **\$10,000 Exception for Compensation Paid by Related Organizations**

The core form generally requires compensation reporting of amounts paid to the filing organization’s officers, directors, trustees and key and highly compensated employees by related organizations. The final instructions clarify that only “reportable” (i.e., W-2 and 1099) compensation paid by a related organization that exceeds \$10,000 should be reported on the core form (although this exception does not apply to other types of compensation, nor to reporting on Schedule J). Note that the final instructions retain the “volunteer exception” to related organization compensation reporting, i.e., compensation paid by a related organization to an officer, director or trustee of the filing organization who serves without compensation need not be reported.

## Clarification of Hospital and Facility Reporting

Schedule H for hospitals need only be completed with certain identifying information about facilities in the first filing year of the new Form 990. The entire schedule, including questions on community benefit, bad debt, Medicare and collection practices and joint ventures, must be completed on the 2009 Form 990. The final instructions clarify that Schedule H must be completed by any organization that operates (directly, or indirectly through a disregarded entity or joint venture) at least one facility that is, or is required to be, licensed, registered or similarly recognized by a state as a "hospital." Facility information must be provided for those facilities that are, or are required to be, licensed, registered or recognized as "health care facilities" for state law purposes. The final instructions also provide additional clarification and examples to assist hospitals in completing the parts of the schedule required for the 2009 Form 990.

## Reporting Exemption for Certain Tax-Exempt Bonds

Beginning with the 2009 Form 990, Schedule K requires organizations that issue tax-exempt bonds to answer a series of questions about proceeds, private business use and arbitrage (on the 2008 form, only identifying information about bonds need be reported). While Schedule K reporting is generally limited to bonds issued after December 31, 2002, the draft instructions stated that refundings after 2002 of pre-2003 bonds would be treated as post-2002 issues and therefore subject to Schedule K reporting. This led to concerns about whether organizations would have adequate records to complete the private use questions. The final instructions state that the private use questions need not be completed with respect to refunding bonds issued after 2002 to refund pre-2003 bonds.

## Contact Information

If you have questions about the new Form 990 or related issues, please contact your usual Ropes & Gray attorney.

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