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A New Level of Transparency for Exempt Organizations: The Form 990 Overhaul for 2008

Tax exempt organizations should be prepared to utilize a revised Form 990 for reporting information about their exempt operations to the public in 2008. The Internal Revenue Service ("IRS") has released the revised final Form 990 and its corresponding schedules and instructions for 2008. The new form includes significant changes from the 2007 Form 990. Specifically, it consists of an 11-page, 11-part core form to be completed by all organizations that file the form, and sixteen (16) schedules to be completed by those organizations satisfying the applicable criteria for each schedule.

Phase-In Periods

The 2008 Form 990 will be phased-in over three (3) years. Organizations with annual revenue of \$25,000 to \$1 million and with assets of less than \$2.5 million will have the option of filing Form 990-EZ for the 2008 tax year. For the 2009 year, the filing threshold allows organizations with revenue between \$25,000 and \$500,000 and with assets of less than \$1.25 million to file Form 990-EZ. In the 2010 tax year and beyond, organizations with between \$50,000 and \$200,000 in revenue and with assets of less than \$500,000 can opt to complete Form 990-EZ instead of the new Form 990.

The IRS is also providing transition relief for the Schedules for Hospitals (Schedule H) and Tax Exempt Bonds (Schedule K). Organizations required to file Schedule H in tax year 2008 will only be required to complete Part V (Facility Information), and organizations required to file Schedule K in tax year 2008 will only be required to complete Part I (Bond Issues). The remaining parts of these schedules are optional for 2008, but will be required beginning in tax year 2009.

The IRS redesigned Form 990 to enhance transparency with the goal of providing the government and the public a more realistic picture of tax-exempt organizations. The IRS initially released a proposed draft of the redesigned Form 990 on June 14, 2007 and sought comments on the redesigned form. The final Form 990 for tax year 2008 was released on December 20, 2007. On April 7, 2008, the IRS released a draft of the Form 990 instructions for public comment. After considering the public comments, the IRS released the final instructions to the form on August 19, 2008. The final versions of the form and the instructions adopt several of the recommendations made during the public comment periods.



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Structure

In response to the public comments, the revised instructions adopt numerous format changes. The terms included in the Glossary are highlighted in bold in the instructions, generally at the first place where the term appears in a line item instruction, and a term's definition in the Glossary is generally not repeated in the instruction's text. The instructions include a sequencing list to help organizations determine the order in which to complete various portions of the form. The instructions also contain new appendices for reporting requirements and guidance regarding group returns (Appendix E) and for organizations to report activities conducted indirectly through joint ventures and disregarded entities (Appendix F).

Part IV, the Checklist of Required Schedules, is new to Form 990 and provides a list of "triggers" to the 990 Schedules. The sequence of questions in Part IV follows the sequence of the schedules and the parts within the schedules. The IRS has indicated that including all of the triggering questions in one section will make it easier for an organization to determine which schedules to complete.

Governance

The IRS has indicated that the existence of an independent governing body and well-defined governance and management policies and practices generally improves tax compliance. Instructions to the new Form 990 indicate that a director will be considered "independent" if (i) the individual was not compensated as an employee or officer of the organization or a related organization; (ii) the individual did not receive independent contractor payments (other than reimbursable expenditures) exceeding \$10,000 during the organization's tax year; and (iii) no transactions are reportable under Schedule L

(Interested Person Transactions) for the individual or a member of his or her immediate family.

The final instructions to the "core form" clarify that an exempt organization only needs to report "significant" changes to its governing documents (e.g., Articles of Incorporation and Bylaws) within the Form 990. Changes should be reported within Schedule O, but copies of the new documents should not be attached. Changes to corporate policies maintained outside the governing documents do not need to be reported. The IRS has indicated that much of the information required for Part VI can be easily completed by an individual who is familiar with the organization's governing instruments, policies, and practices without having to undertake significant due diligence.

Compensation (Schedule J)

The redesigned Form 990 revises Part VII as to the reporting of executive compensation and transactions with interested persons. It also extends the reporting of compensation paid to an organization's five (5) highest compensated individuals and five (5) highest paid independent contractors to all organizations filing Form 990. The new form also raises the reporting threshold for the top five (5) highest compensated individuals from \$50,000 to \$100,000. Generally, organizations that pay compensation greater than \$150,000 to a person required to be listed on the core form would also need to provide additional compensation information in Schedule J. The new instructions clarify that both "reportable compensation" and "other compensation" are included within Schedule J and provide definitions and examples for each.

The definitions that apply to the compensation disclosure requirements differ from the prior forms. In particular, the final instructions indicate that "key employees" include those employees,



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other than officers, directors, and trustees, who: (1) had reportable compensation exceeding \$150,000 for the year (the “\$150,000 Test”); (2) had or shared organization-wide control or influence similar to that of an officer, director, or trustee, or managed or had authority or control over at least ten percent (10%) of the organization’s activities (the “Responsibility Test”); and (3) were within that group of the organization’s top twenty (20) highest paid employees for the year who satisfied both the \$150,000 test and the Responsibility Test (the “Top 20 Test”).

For reporting purposes in Schedule J, an officer is determined by reference to the organization’s state law and governing documents but always includes the organization’s top management official (CEO or equivalent) and top financial official (CFO or equivalent). A director or trustee is generally determined by reference to the organization’s state law and governing documents. The instructions further clarify that an organization would need to report information on a person who is a former top five (5) highest compensated employee if such person (1) was not an employee of the organization at any time during the calendar year, (2) received reportable compensation exceeding \$100,000 for the calendar year, and (3) received reportable compensation that would place the former employee among the organization’s current five (5) highest paid employees if the individual had been employed by the organization during the calendar year.

Hospitals (Schedule H)

Any exempt organization that operates at least one facility that is, or is required to be, licensed, registered, or similarly recognized by a state as a “hospital,” is required to complete Schedule H, which includes six (6) parts. Exempt organizations must also list each hospital or other facility that is licensed, registered or similarly recognized by a state as a “health

care facility,” including facilities other than licensed hospitals. As indicated above, Parts I, II, III, IV and VI of Schedule H are optional for the 2008 tax year.

Organizations filing Schedule H must aggregate information from (1) hospitals directly operated by an organization, (2) hospitals operated by disregarded entities of which the organization is the sole member, (3) other facilities or programs of the organization or its disregarded entities even if provided by a facility that is not a hospital or if provided separately from the hospital’s license, and (4) hospitals operated by any joint venture taxed as a partnership to the extent of the organization’s proportionate share of the joint venture. The instructions for Part III, Section A clarify that the IRS does not require organizations to adopt HFMA Statement 15 or use it to determine bad debt expense or charity care costs to complete the schedule.

Tax Exempt Bonds (Schedule K)

Schedule K replaces the unstructured attachment formerly required by 2007 Form 990, line 64a, and requires additional information reporting on bonds issued after 2002. The IRS has indicated that the one (1) year delay for completing most of the portions of this schedule should provide organizations an opportunity to put in place systems needed to compile the necessary information. In the final instructions, the IRS clarified that Part III of Schedule K does not need to be completed for post-2002 refundings of bonds issued prior to 2003.

Transactions with Interested Persons (Schedule L)

Excess benefit transactions, loans, grants and other financial transactions with certain “interested persons” must be reported in Schedule L. Interested persons include officers, directors, trustees, key employees, the five highest compensated employees



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previously reported in Part VII of the core form, and disqualified persons (as defined in the excess benefit transactions regulations). The final instructions indicate that reportable transactions are determined based on when payments were made as opposed to when the parties agreed upon the transaction.

Related Organizations (Schedule R)

Schedule R was added to Form 990 in an effort to make the increasingly complex organizational structures of tax exempt organizations more transparent. The schedule contains separate parts to report information on disregarded entities, related tax-exempt organizations, related organizations which are taxable as partnerships, and related organizations that are taxable as corporations or trusts. Schedule R extends the 2007 form's Schedule A, Part VII reporting of various transfers from charities to all types of exempt organizations, with an exception for reporting with respect to tax-exempt transferees that were not controlled by the organization. All filing organizations are required to complete Schedule R with information regarding transfers between controlled entities. Schedule R adds reporting on unrelated partnerships through which the organization conducts significant exempt, business, or investment activities.

Summary

While the new 2008 Form 990 will likely provide greater transparency to the public, it is also likely, at least initially, to produce a greater burden to those organizations completing the form. Copies of the forms, instructions and guidance documents published by the IRS can be downloaded at <http://www.irs.gov/charities/index.html>. Exempt organizations should take steps necessary to gather the information necessary to complete the new Form 990, implement internal policies and procedures to address the increased reporting obligations within the new form, anticipate any problems (e.g., compliance, public relations, internal processes) that may face the organization in satisfying the new reporting obligations, and establish deadlines and a review and audit process for completing the form and preparing it for submission to the IRS.

If you would like additional information on the changes made to the 2008 Form 990 or if you would assistance in preparing your organization to complete the form, please contact James M. Daniel, Jr. or Michael R. Newby, who are attorneys in the HJDN Richmond, Virginia office by telephone at 804.967.9604 or by email at jdaniel@hdjn.com or mnewby@hdjn.com.

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