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**Governance Issues:
Impact of the Revised Form 990**

By

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Government Entities (“ACT”) is an organized public forum that provides the IRS with public comments regarding critical tax administration matters. ACT provides regular input to the Tax Exempt and Government Entities Division. ACT members represent employee plans, exempt organizations, tax-exempt bonds, and Federal, state, local, and Indian tribal government. ACT members are appointed by the Secretary of the Treasury.....	4
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3.	Other Non-Fixed Payments. The organization must also describe any non-fixed payment other than compensation contingent on revenues or net earnings with respect to a listed person. Schedule J, at Part I(7). Non-fixed payments are defined as payments that are not an amount of cash or other property specified in the contract, nor determined by a fixed, non-discretionary, formula specified in the contract. Schedule J Instructions, at Part I(7). Amounts payable pursuant to a qualified pension, profit-sharing, or stock bonus plan under § 401(a), or pursuant to an employee benefit program that is subject to and satisfies coverage and nondiscrimination rules under the Internal Revenue Code are treated as fixed payments, and therefore, are not required to be reported. <i>Id.</i>	19
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	• The balance due at the end of the organization’s tax year;.....	22
	• Whether any payment of the debtor was past due or if the debtor is otherwise in default;.....	22
	• Whether the board approved the loan transaction; and,.....	22
	• Whether the loan is evidenced by a promissory note or other written agreement signed by the debtor. Schedule L, at Part II.	22
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because SOX prohibits loans from public companies to their officers and directors, *see* SOX § 402, 15 U.S.C. 78 *et seq.*, such loans tend to be viewed as indicators of poor corporate governance. If a tax-exempt organization does make a loan to an officer or director, the loan should be approved by the board of directors, evidenced by a written promissory note, and should be subject to a market interest rate for comparable loans. If the loan is not subject to market interest rates, the value of the benefit of the below market interest rate should be reported as income. *See* I.R.C. § 7872.....22

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	• The type of relationship between the interested person and the organization; and,.....	24
	• The cash amount of the transaction or fair market value of the assets or services provided by the organization;.....	24
	• The type of transaction; and,.....	24
	• Whether all or part of the consideration paid by the organization was based on a percentage of revenues of the organization. Schedule L, at Part IV	24
3.	Business Transactions. “Business transactions” include, but are not limited to, contracts of sale; leases; licenses; performance of services; joint ventures, whether new or ongoing, in which either the profits or capital interest of the organization and of the interested person each exceed 10%; and, transactions between the organization and a management company of which a former officer, director, trustee, or key employee of the organization within the last five tax years is a direct or indirect 35% owner, officer, director, trustee, or key employee. Schedule L Instructions, at Part IV.	25
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	• An entity more than 35% owned, directly or indirectly, individually or collectively, by current or former officers, directors, trustees, or key employees, or their family members;	25
	• An entity, other than a 501(c), of which a current or former officer, director, trustee, or key employee was serving at the time of the transaction as an officer; director; trustee; key employee; partner or member with an ownership interest in excess of 5%, if the entity is treated as a partnership; or, a shareholder with an ownership interest in excess of 5%, if the entity is treated as a professional corporation. Schedule L Instructions, at Part IV.....	25
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**Governance Issues:
Impact Of The Revised Form 990**

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I. Introduction

A. Revised Form 990

On December 20, 2007, the Internal Revenue Service (the “IRS” or the “Service”) released a redesigned Form 990, *Return of Organization Exempt From Income Tax*. The new Form 990 includes a section on governance as well as sections on compensation and related party transactions which have a significant governance component.

The revised Form 990 was years in the making. On June 14, 2007, the IRS had released for public comment a discussion draft of a redesigned Form 990. On December 20, 2007, the IRS released the new 2008 Form 990 for tax year 2008 (to be filed in 2009 and later years), incorporating changes in response to comments and suggestions from approximately 700 e-mails and letters received during the comment period that ended on September 14, 2007.

On April 7, 2008, the IRS released for public comment the draft instructions to the 2008 Form 990. On August 19, 2008, the IRS released the revised instructions that most tax-exempt organizations will need to fill out the 2008 Form 990. The instructions incorporate changes in response to comments and suggestions from approximately 120 e-mails and letters received during the comment period that ended on June 1, 2008.

B. Environment Leading to IRS’ Emphasis on Governance

The IRS’ actions are part of an era of increased emphasis on “best practices” in corporate governance for nonprofit organizations. Scandals in both the public company and the nonprofit sector led to an increased focus on corporate governance which has been evidenced by:

- Enactment of Sarbanes-Oxley Act (“SOX”) in 2002, which directly mandated or required the SEC or other bodies to enact, a large number of corporate governance reforms applicable to public companies.
- Congressional Oversight: The Senate Finance Committee, the House Committee on Ways and Means and its Subcommittee on Oversight have held hearings on nonprofit issues, as well as released discussion drafts on corporate governance and other matters concerning the nonprofit sector.
- State Action: Several state legislators have considered enacting laws imposing governance standards on nonprofits. The most far reaching is the California Nonprofit Integrity Act of 2004, CAL. GOV’T CODE §12585-86, 12599 (2004).

- Panel on the Nonprofit Sector: An independent panel on the nonprofit sector was formed by Independent Sector at the encouragement of the Senate Finance Committee “to consider and recommend actions that will strengthen good governance, ethical conduct and effective practice of public charities and private foundations.” Panel on the Nonprofit Sector, *About the Panel on the Nonprofit Sector*, <http://www.nonprofitpanel.org/about/Index.html>. The Panel on the Nonprofit Sector issued *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations* in October 2007.
- Watch Dog Groups: For example, the Better Business Bureau has published “Standards for Charity Accountability” and Charity Navigator provides “organizational efficiency” ratings.

II. Appropriate Role of IRS in Governance

A. The IRS View

On Form 990, in the heading of the Governance section, the IRS states that the section “request[s] information about policies not required by the Internal Revenue Code.” However, the IRS believes that it has “implicit jurisdiction” over organizational governance. Steven T. Miller, I.R.S. Comm’r, Tax Exempt and Government Entities, Remarks at the Georgetown Law Center Seminar on Representing and Managing Tax-Exempt Organizations (April 24, 2008). The IRS believes its authority is found in the nexus between good governance and tax compliance. Steven T. Miller, I.R.S. Comm’r, Tax Exempt and Government Entities, Remarks at the Georgetown Seminar on Exempt Organizations: Panel on Nonprofit Governance (Apr. 23, 2008). Steven Miller, the IRS Commissioner of Tax Exempt and Government Entities, acknowledges that there is a “jurisdictional gap” due to the “absence of explicit federal statutory provisions setting forth clear governance standards.” *Id.* Nevertheless, he believes that governance is clearly within the IRS’ purview because:

[T]he effects of good or bad nonprofit governance cut across virtually everything [the IRS] see[s] and do[es] in [its]work. It impacts whether the organization is operated to further exempt purposes and public, rather than private, interests. It dictates whether the organization's executives are compensated fairly or excessively. It influences whether the organization makes informed and fair decisions regarding its investments or its fundraising practices, or allows others to take unfair advantage.

Id. Commissioner Miller has called promoting standards of good governance, management and accountability one of the pillars of IRS’ compliance program. Steven T. Miller, I.R.S. Comm’r, Tax Exempt and Government Entities, Remarks before the Philanthropy Roundtable: The IRS’s Role in an Evolving Charitable Sector (Nov. 10, 2007).

B. Challenges to IRS Authority

1. **Legal Basis for Challenge.** The opposing view is summarized in an article by Marcus S. Owens. See *United States: Charities And Governance: Is The IRS Subject To Challenge?*, Tax Analyst, Doc 2008-9664 (Nov. 12, 2008). Owens notes that section 6033(a)¹ grants the Department of Treasury and the IRS “broad authority to design returns to collect information for the ‘purpose of carrying out the Internal revenue laws.’” *Id.* However, there are limits to the IRS’ ability to compel information. In *United States v. Powell*, the Supreme Court stated that “an IRS summons must satisfy four specific requirements to be enforceable: it must be for a legitimate purpose; the information requested under the summons must be relevant to that purpose; the information must not yet be in the possession of the IRS; and the summons must be issued and served under proper procedures.” *Id.*, (citing 379 U.S. 48, 57-58 (1964)). Owens argues that the view “[t]hat a charity’s governance policies and procedures, beyond those specified by the code, may reflect its institutional attitude toward general tax compliance would not appear to meet the Powell requirement of relevancy to a potential tax liability.” *Id.*

Owens also points to the legislative history of section 6033(a) as evidence that the IRS has exceeded its authority. Owens cites to GCM 38382, in which the chief counsel states that:

Section 6033(a) was amended by section 101(d)(1) of the Tax Reform Act of 1969, so that it authorized that returns filed under section 6033 could include information to carry out “the internal revenue laws,” rather than just “the provisions of subtitle A.” The legislative history indicates that the language in section 6033(a) was broadened for a specific and relatively narrow purpose -- to enable the Secretary to require that returns under section 6033 should include information needed to enforce the prohibitions against self-dealing and related activities, most of which were added by the Tax Reform Act of 1969. See H. Rep. No. 91-413, 91st Cong., 1st Sess. 36 (1969). The prohibitions against self-dealing and related activities are found in chapter 42 of subtitle D rather than in subtitle A. Thus, Congress never envisioned that returns filed under section 6033 as amended would be used to elicit from exempt organizations information that might relate to the wagering excise tax, and, accordingly, section 6501(g)(2) has never been expanded to apply to wagering excise tax liability.

Id. (citing GCM 36372 (Aug. 11, 1975)). Owens concludes that “[c]learly, an argument can be made that the IRS has exceeded its authority by incorporating questions on governance and other matters that, by its own admission, are not required by the code.” *Id.*

However, Owens goes on to say that options for judicial review are limited.

2. **Comments on Form 990.** A number of comments on the Form 990 questioned the authority of the IRS to require information concerning a filing organization’s

¹ Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended (the “Code”).

governance practices. For example, GuideStar noted that the form “goes beyond the information required by the Internal Revenue Code” and that what a given organization does regarding “best practices” is a matter for the business judgment of the organization.”

3. Advisory Committee on Tax-Exempt and Government Entities

Reports. The Advisory Committee on Tax-Exempt and Government Entities (“ACT”) is an organized public forum that provides the IRS with public comments regarding critical tax administration matters. ACT provides regular input to the Tax Exempt and Government Entities Division. ACT members represent employee plans, exempt organizations, tax-exempt bonds, and Federal, state, local, and Indian tribal government. ACT members are appointed by the Secretary of the Treasury.

In a 2006 report, entitled “Policies and Guidelines for Form 990 Revision,” the ACT recommended that “[t]o ensure that the form remains focused on meeting the Service’s core mission, Form 990 should be designed to determine compliance with federal tax law.” Advisory Comm. on Tax Exempt and Gov’t Entities, *Policies and Guidelines for Form 990 Revision* 23 (Jun. 7, 2006). Additionally, the ACT report stated that “[e]videntiary questions should be formulated to obtain evidence or facts which will reveal whether the filer has complied with federal tax law” and that “[q]uestions regarding governance “best practices” . . . are probably insufficiently connected to the elements of any violation of the tax code to prompt the efficient use of enforcement resources.” *Id.*, at 26.

The 2008 ACT report, entitled “The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues,” stated that the IRS should proceed cautiously in organizational governance because there “is little or no empirical evidence to date that supports the efficacy of any specific governance practices by nonprofit organizations, much less compliance with the requirements for maintaining tax exemption.” Advisory Comm. on Tax Exempt and Gov’t Entities, *The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues*, 1 (Jun. 11, 2008).

The 2008 ACT report stated concerns about the influence of practice and policy questions on Form 990. The 2008 ACT report acknowledges that:

[E]ven the most modest level of prescription from a regulatory body such as the IRS regarding what constitutes “good governance” can undermine the fundamental and wholly legitimate authority of the organization’s governing board and can suggest a one-size-fits-all approach that can place undue burdens on an organization, divert the organization’s attention from meaningful governance to policies and procedures, and do damage to the uniquely diverse and vibrant charitable sector in this country.

Id. at 4. It is imperative that organizations recognize that most of the governance practices asked about are not mandated. When considering whether to adopt such practices, organizations must remember that “[g]iven the diversity of the sector and the varying, and often unpredictable, challenges facing an organization, the organization’s governing board generally is in the best position to determine what the most appropriate practices are for its organization.” *Id.*

C. Practitioners' Approach

1. Balance Different Considerations. Formulating the proper response to governance questions on the Form 990 requires exempt organizations and their advisors to balance several considerations. Some of the considerations are listed in this section.

2. Avoiding IRS Audits. Nonprofits naturally and appropriately want to avoid actions that are likely to lead to an IRS audit. Thus, to the extent that a nonprofit can provide answers regarding governance that comport with the IRS' views of good governance, it should do so.

3. IRS Authority. Consider whether the question relates to a direct requirement of the Internal Revenue Code such as section 4958 provisions on excess benefit transactions, private inurement or private benefit. These questions are intended to be educational and to determine whether the filing organization is in compliance with the tax law.

4. Compliance with State Law. Governance questions are governed by state law -- usually the law of the state in which a nonprofit corporation or trust is incorporated. While state laws are similar and all embody the duty of care and the duty of loyalty, there are differences. For example, California has enacted the Nonprofit Integrity Act CAL. GOV'T CODE §12585-86, 12599 (2004) which imposes requirements on charities, commercial fundraisers, fundraising counsel, unincorporated associations, and trusts concerning registration, audit requirements, audit committees, compensation reviews and fundraising accountability. Additionally, a corporation must comply with its corporate documents, which must meet the requirements of state law.

5. Role of Governing Body. The governing body has a fiduciary duty to act in the best interests of the nonprofit and should not adopt procedures that it believes are not appropriate for its organization. For example, a governing body may decide that the resources required to adopt some of the written policies that are the subject of questions in the Form 990 outweigh the benefits for their organization.

6. The Public and the Media. Because the Form 990 is available to the public, a nonprofit organization should also consider the reaction of the media and the public to its answers on the Form 990. The Form 990 should present the filing organization in the most favorable light possible consistent with the duty to file an accurate return. A critical media story can affect an organization's reputation and lead to Congressional inquiries.

7. Avoiding Penalties for Failure to File

a. Penalties on the Organization. If an organization fails to file Form 990, fails to file a complete Form 990, or files a Form 990 that contains incorrect information, it may be assessed penalties. I.R.S. Form 990, Instructions (2008) (hereinafter "Instructions"). Code section 6652(c)(1)(A) prescribes a penalty of \$20 a day until a complete, correct form is filed, not to exceed the smaller of \$10,000 or 5% of the gross receipts of the organization for the year. *Id.* If an organization's gross receipts exceed \$1 million, it may be assessed a penalty of \$100 a day, with a maximum penalty of \$50,000. *Id.* The penalty is

assessed from the due date for filing Form 990. *Id.* If the organization can provide reasonable cause for the failure to file, then no penalty will be imposed. I.R.C. § 6652 (c)(3).

b. Penalties on Responsible Persons. When an organization fails to file Form 990, fails to file a complete Form 990, or files a Form 990 that contains incorrect information, the IRS will send a letter to the organization that provides a deadline for a complete, correct form to be filed. If the organization does not comply by the deadline, the person responsible for the non-compliance will be assessed a penalty of \$10 a day, not to exceed \$5,000. Penalties may also be assessed under Revenue Code sections 7203, 7206, and 7207 for willfully not filing returns and for filing fraudulent returns and statements with the IRS. *Id.* Those penalties include both fines up to \$100,000 and imprisonment up to three years. I.R.C. §§ 7203; 7206; 7207.

c. Requirements for a Properly Completed Form. According to the Form 990 instructions, the form will be considered properly completed only if an entry is made on every line requiring an amount or information. I.R.S. Form 990 Instructions, at Part J. However, according to several Chief Counsel Memoranda, incomplete return penalties will only be assessed if the omitted information is “material and thus necessary for the proper administration of the tax laws.” GCM 36372 (Aug. 11, 1975); *see also* GCM 36372 (Aug. 11, 1975); GCM 36506 (Dec. 8, 1975).

d. Use of Outdated Form. According to an internal IRS memo from the Office of Chief Counsel, the IRS may apply failure to file penalties to taxpayers who file the outdated version of the Form 990 instead of the redesigned version. *See* Memo from Michael B. Bluemfeld, Senior Technician Reviewer, Exempt Organizations Branch 1, to David L. Fish, Manager, EO Technical Guidance & Quality Assurance (Aug. 5, 2008), *Tax Analyst*, Doc # 2008-24585.

III. Form 990, Part VI: Governance, Management, and Disclosure

A. Heading

The heading of Form 990 Part VI states that “Sections A, B, and C request information about policies not required by the Internal Revenue Code.” The instructions to Part VI, however, state that all organizations must answer each question in Part VI, noting that the IRS considers such policies and procedures to generally improve tax compliance.

B. Governance Structure

1. Size of Board. The filing organization must disclose the total number of directors. I.R.S. Form 990 (hereinafter “Form”), Part VI(A)(1)(a) (2008). Any differences in voting rights among the directors must be explained. Instructions, at Part VI(A)(1)(a). If the board delegated broad authority to act on its behalf to a committee during the organization’s tax year, then the organization must describe the composition of the committee, whether any of the committee’s members are not members of the board, and the scope of the committee’s authority. *Id.*

a. Many governance experts believe that boards of approximately 9 to 12 directors are the optimum size because a board of that size is small enough to engage in discussion and yet large enough to represent diverse viewpoints, experiences and skills. It is recognized, however, that the appropriate size depends upon the needs of the organization. Some state laws require a minimum number of directors.

2. Independent Directors

a. **Disclosure.** The organization must disclose the number of “independent directors.” *Id.*, Part VI(A)(1)(b). An independent director is defined as a voting member of the board who is:

- Not compensated as an officer or other employee of the organization or an related organization;
- Not receiving more than \$10,000 as an independent contractor from the organization;
- Not receiving material financial benefits; and,
- Whose family members have not received compensation or material financial benefits. Instructions, at Part VI(A)(1)(b).

b. Standard of Diligence

i. The organization must make a “reasonable effort” to obtain the information necessary to determine the independence of members of the governing body. *Id.* The organization may rely on information provided by the members of the governing body. *Id.*

ii. An example of a reasonable effort provided by the IRS in the Form 990 Instructions is sending out an annual survey to each member of the governing body that includes the reporting member’s name, title, date, signature, and the instructions and definitions relevant for determining whether the member is independent. *Id.*

c. **Influence of SOX.** The required disclosure of independent directors appears to be inspired by SOX. SOX requires that each member of a public company audit committee be independent, as defined in SOX. The New York Stock Exchange and other stock exchanges amended their listing rules at the request of the Securities and Exchange Commission to require that a majority of a listed company’s directors be independent and that certain key committees be composed entirely of independent directors, as defined in each exchange’s rules.

3. **Management Company.** The filing organization must disclose whether control over management duties that are customarily performed by, or under the direct supervision of, officers, directors, trustees, or key employees was delegated to a management company. Form, at Part VI(A)(3).

4. Changes to Corporate Documents. The filing organization must disclose any significant changes to its organizational documents or its bylaws. Form, at Part VI(A)(4).

5. Organizational Form

a. The filing organization must state whether it has members or stockholders. *Id.*, at Part VI(A)(6). An organization must answer affirmatively if it is organized as a stock corporation, a joint-stock company, a partnership, a joint venture, or limited liability company; or, a non-stock, non-profit, or not-for-profit corporation or association with members. *Id.*, at Instructions, Part VI(A)(6).

b. Transactions with members or stockholders may result in private inurement or private benefit.

6. Rights of Members or Stockholders. The filing organization must state whether it has members, stockholders or other persons who had the right to elect or appoint one or more members of the organization's board, or who had the right to approve or ratify decisions of the board. *Id.*, at Part VI(A)(7).

C. Conflicts of Interest

1. Written Conflict of Interest Policy

a. The filing organization must state whether it has a written conflict of interest policy that defines conflicts of interest, identifies the classes of individuals within the organization covered by the policy, facilitates disclosure of information that may help identify conflicts of interest, and specifies procedures to be followed in managing conflicts of interest. Form, at Part VI(B)(12); Instructions, at Part VI(B)(12)(a).

b. The Service has published a conflicts of interest policy that was originally developed for hospitals but can be used by other organizations. The Service now asks on Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, whether the applicant organization has adopted a conflict of interest policy. While it is not required as a condition of tax exemption, anecdotal evidence indicates that some determination specialists require such a policy as a condition of exemption. The Service's template for a conflicts policy is included in the Form 1023 instructions. Note, however, that the Service's definition of a conflict in its template and in the Form 990 instructions is limited to situations where a person covered by the policy may benefit financially from a transaction of the organization. Another form of conflict of interest is when a director owes a duty to two separate organizations. Organizations should consider including a more expansive definition of conflict of interest in their policies than the definition used by the IRS.

2. Annual Disclosure. The filing organization must also state whether it requires officers, directors, trustees, and key employees to annually disclose or update their interests that could give rise to conflicts. Form, at Part VI(B)(12)(b). This requirement goes to the organization's enforcement of the policy.

3. Enforcement. The filing organization must disclose whether and how it regularly monitors and enforces compliance with the policy. *Id.*, at Part VI(B)(12)(c). Appropriately, the IRS is seeking to encourage organizations to not only adopt conflict of interest policies but also to enforce them.

4. Intra-board Relationships

a. The filing organization must disclose any family or business relationships among its officers, directors, trustees, or key employees. *Id.*, at Part VI(A)(2). The organization must identify the persons involved in such relationships and the type of relationship. Instructions, at Part VI(A)(2).

b. A “family relationship” is defined as a spouse, ancestor, whole or half sibling, child, grandchild, great grandchild, and the spouse of a brother, sister, child, grandchild, and great grandchild. I.R.S. Form 990 Glossary (2008).

c. The following are considered “business relationships”:

- Employment with an organization with which the other party is a trustee, director, officer, key employee, or greater than-35% owner;
- Direct or indirect business transactions with an aggregate value of more than \$10,000; and,
- Both parties are officers, directors, trustees or greater than 10% owners in the same business or investment entity. Instructions, at Part VI(A)(2).

d. Standard of Diligence

i. The filing organization must make a “reasonable effort” to obtain the information necessary to determine whether there are any intra-board relationships. *Id.* The organization may rely on information provided by those persons. *Id.*

ii. An example of a reasonable effort provided by the IRS in the Instructions is sending out an annual survey to each member of the governing body that includes the reporting person’s name, title, date, signature, and the instructions and definitions relevant for determining whether the member has an intra-board relationship. *Id.*

e. Questions about intra-board relationships are intended to uncover relationships that may affect a director’s judgment and ability to act in the best interest of the organization. A high percentage of related directors on a board and/or a low percentage of independent directors might be viewed by the IRS as a factor that tends to lead to lack of tax compliance.

5. Diversion of Assets

a. The filing organization must disclose any material diversion of assets, including diversions that occurred in prior years that the organization became aware of during the tax year. Form, at Part VI(A)(5); Instructions, at Part VI(A)(5). A “diversion” includes any unauthorized conversion or use of the organization’s assets. Instructions, at Part VI(A)(5). A diversion is “material” if the gross dollar amount is more than the lesser of \$250,000 or 5% of gross receipts or total assets. *Id.*

b. Although included under conflicts of interest, diversion of assets may occur not only in situations where there is a conflict of interest but also in other situations. It may include theft or embezzlement as well as private inurement and excess benefit transactions. Instructions, at Part VI(A)(5).

D. Policies and Procedures

1. Minutes of Board Meetings

a. The filing organization must state whether board meetings or written actions were contemporaneously documented. Form, at Part VI(A)(8). “Contemporaneous” is defined as the later of the date of the next board meeting or 60 days after the date of the meeting or written action. Instructions, at Part VI(A)(8).

b. Many state laws require that the organizations keep minutes of meetings of its board of directors, board committees, and members and such minutes are unquestionably considered good governance.

2. Affiliates and Branches

a. The filing organization must state whether it had any local chapters, branches, lodges, units, or similar affiliates that it had legal authority to supervise and control and that were not separate legal entities. Form, at Part VI(A)(9)(a); Instructions, at Part VI(A)(9)(a). If so, the organization must disclose whether it has written policies and procedures to ensure that the affiliates’ operations are consistent with the organization, or explain how it otherwise ensures that local activities are consistent. Form, at Part VI(A)(9)(b); Instructions, at Part VI(A)(9)(b).

b. If the organization is the parent organization of a group exemption, it has a duty to exercise oversight over its subordinate organizations.

3. Review of Form 990. The filing organization must state whether a copy of Form 990 was provided to each member of the board prior to filing. Form, at Part VI(A)(10); Instructions, at Part VI(A)(10). Also, it must state whether any officers, directors, trustees, board committee members, or management reviewed the Form 990 prior to filing. Instructions, at Part VI(A)(10). If so, the organization must disclose the process of review, including who conducted the review, when the review was conducted, and the extent of the review. Form, at Part VI(A)(10); Instructions, at Part VI(A)(10).

4. Whistleblower Policy

a. The filing organization must state whether it has a written whistleblower policy. Form, at Part VI(B)(13).

b. The Instructions define a whistleblower policy as a policy that encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported. Instructions, at Part VI(B)(13 and 14).

c. This question is inspired by SOX. SOX has two provisions that deal with whistleblower policies. One makes it a criminal offense to retaliate against any person who provides truthful information relating to the commission or possible commission of a federal offense. SOX, § 1107, 18 U.S.C. 1513(e). The other requires the Audit Committee to establish procedures for the receipt, retention and treatment of complaints regarding questionable accounting or auditing matters which protect the confidentiality of employees. SOX, § 301, 15 U.S.C. 78 *et seq.*

5. Document Retention and Destruction Policy

a. The filing organization must state whether it has a written document retention and destruction policy. Form, at Part VI(B)(14).

b. The instructions define a document retention and destruction policy as a policy that identifies the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records. Instructions, at Part VI(B)(13 and 14).

c. This provision is inspired by SOX. SOX makes it a criminal offense to knowingly alter, destroy, mutilate, conceal, cover up or falsify any record, document or tangible object with the intent to impede, obstruct or influence the investigation or administration of a matter within the jurisdiction of any US agency or bankruptcy case. SOX, § 801, 18 U.S.C. 1519. The instructions also note that organizations are required to keep records relevant to its tax exemption and its filings with the IRS.

6. Compensation

a. The filing organization must state whether the process for determining compensation for the CEO, other officers, and key employees includes a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision. *Id.*, at Part VI(B)(15). If so, the decision making process must be described, including the identity of the positions for which the process was used, and the year in which the process was last undertaken for each such person. Instructions, at Part VI(B)(15).

b. This provision, Part VII, and Schedule J, which are discussed below, provides information concerning potential excess benefits and whether the organization has complied with the requirements for the rebuttable presumption of reasonableness. *See* Treas.

Reg. § 53.4958-6. The Service has indicated its intention to focus on compensation and has said this inquiry is of particular importance to the I.R.S. Ronald J. Schultz, Senior Technical Advisor in the Tax Exempt & Gov't Entities Div., I.R.S., Panelist at the American Bar Association Teleconference: The New IRS Form 990 Focus on Nonprofit Governance: Is Your Board Ready? (Oct. 1, 2008).

7. Joint Ventures

a. The filing organization must disclose whether it participated in any joint ventures, or similar arrangements, with a taxable entity. Form, at Part VI(B)(16)(a). If so, the organization must state whether it adopted a written policy or procedure that requires the organization to negotiate in its transactions and arrangements with the other members of the venture or arrangement such terms and safeguards adequate to ensure that the organization's exempt status is protected, and that it has taken steps to safeguard the organization's exempt status with respect to the venture or arrangement. *Id.*, at Part VI(B)(16)(b).

b. This provision elicits information concerning IRS requirements that exempt organizations must take to avoid having a joint venture threaten its exempt status. *See* Rev. Rul. 98-15, 1998-1, C.B. 718; Rev. Rul. 2004-51, 2004-1 C.B. 975. However, the IRS has not previously suggested that exempt organizations should adopt written policies or procedures concerning joint ventures.

E. Transparency and Points of Contact

1. Contact Information. The filing organization must provide the address for any officer, director, trustee, and key employee who cannot be reached at the organization's mailing address. Instructions, at Part VI(A)(11).

2. State Filings. The filing organization must list the states where it is required to file Form 990. Form, at Part VI(C)(17).

3. Public Availability of IRS Forms. The filing organization must disclose whether its Form 990, 990-T (501(c)(3)s only), and 1023 (or 1024 if applicable) are available to the public on the Web or upon request. *Id.*, at Part VI(C)(18). If the forms are not publicly available upon request, then the organization must explain the reason. Instructions, at Part VI(C)(17). Exempt organizations are required by the Code to make these forms available to the public. *See* IRC § 6104.

4. Public Availability of Policies. The filing organization must describe whether and how its governing documents, conflict of interest policy, and financial statements are made public. Form, at Part VI(C)(19). There is no legal requirement to make such policies public.

5. Books and Records. The filing organization must provide the name and contact information for the person who possesses the organization's books and records. *Id.*, at Part VI(C)(20).

IV. Form 990, Part VII: Compensation

A. Section A: Compensation of Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1. **Required Information.** The filing organization must list the average weekly hours, the reportable compensation (Form W-2 or 1099), and the estimated amount of other compensation from the organization and related organizations for the following persons:

- **Officers, directors or trustees** that served at any time during the organization’s tax year;
- The twenty highest compensated **key employees** who were employed by the organization during the calendar year ending with or within the organization’s tax year;
- The five **highest compensated** employees employed during the calendar year ending with or within the organization’s tax year;
- **Former** directors, trustees, officers, key employees, and highest compensated employees. *Id.*, at Part VII(A)(1)(a).

2. **Definition of Officer.** An “officer” is defined as a person elected or appointed to manage the organization’s daily operations. Instructions, at Part VII(A). Regardless of title, the person who has the ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration or operation of the organization is considered an officer. *Id.* Also regardless of title, the person who has ultimate responsibility for managing the organization’s finances is considered an officer. *Id.*

3. **Definition of Director or Trustee.** A “director” or “trustee” is defined as a member of the organization’s governing body who has voting rights. *Id.*

4. Definition of Key Employee

a. A “key employee” is defined as an employee of the organization who receives over \$150,000 of reportable compensation from the organization and any related organization, and whose responsibilities meet one of the following tests:

- The employee has responsibilities, powers or influence over the organization as a whole that is similar to those of officers, directors, or trustees;
- The employee manages a discrete segment or activity of the organization that represents 10% or more of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole; or,

- The employee has or shares authority to control or determine 10% or more of the organization’s capital expenditures, operating budget, or compensation for employees. *Id.*
- b.** An individual who is not an employee of the organization, or of a disregarded entity of the organization, is considered a key employee if he or she serves as an officer or director of a disregarded entity of the organization and otherwise meets the criteria to be a key employee. *Id.*
- c.** Management companies and similar entities that are independent contractors should not be reported as key employees. *Id.*

5. Definition of Highest Compensated Employees. “Highest compensated employees” are employees of the organization who (i) are not officers, directors, trustees, or key employees and (ii) receive more than \$100,000 of reportable compensation from the organization and any related organization. *Id.*

6. Former Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

a. Information for former officers, directors, trustees, key employees, and highest compensated employees must be reported if both of the following conditions apply:

- The organization reported, or should have reported, the individual as an officer, director, trustee, or key employee on any of the organization’s Forms 990, 990-EZ, or 990-PF for one or more of the five prior years; and
- The individual received reportable compensation in the calendar year ending with or within the organization’s current tax year in excess of \$100,000 for former officers and key employees, and more than \$10,000 for services in the capacity as a director or trustee. *Id.*

b. Under the heading “Transition rules for non-section 501(c)(3) organizations,” the Instructions state that organizations other than 501(c)(3) organizations are not required to report any former highest compensated employees for the 2008 Form 990. *Id.*

7. Special Rules for Related Organizations

a. Compensation paid by a related organization must be reported only if the total dollar amount is \$10,000 or more for the calendar year ending with or within the organization’s tax year; or if the compensation is paid for past services to the filing organization in the person’s capacity as a former director or trustee. *Id.*

b. Disregarded entities are not considered related organizations. For the purposes of Form 990 and its schedules, disregarded entities are treated as part of the organization. *Id.*

c. Standard of Diligence

i. The filing organization must make a “reasonable effort” to obtain the information on compensation paid by related organizations. *Id.* If the filing organization is unable to obtain such information, it must report its efforts on Schedule O. *Id.*

ii. An example of a reasonable effort provided by the IRS in the Instructions is sending out an annual survey to each listed person that includes the reporting person’s name, title, date, signature, and the instructions and definitions relevant for determining the amount of compensation from the related organization. *Id.*

8. Other Compensation

a. “Other compensation” generally includes compensation not reported as wages on Form W-2 or Form 1099-MISC, including nontaxable benefits. *Id.* The following items must be included as other compensation:

- Tax deferred contributions by the employer to a qualified defined-contribution retirement plan;
- The annual increase in actuarial value of a qualified defined-benefit plan, whether or not funded or vested;
- The value of health benefits provided by the employer, whether or not qualified, that are not included in reportable compensation;
- Tax-deferred contributions by the employer and employee to a non-qualified defined contribution plan, whether or not funded, vested, or subject to a substantial risk of forfeiture; and,
- The annual increase in actuarial value of non-qualified defined benefit plan, whether or not funded, vested, or subject to a substantial risk of forfeiture. *Id.*

9. Compensation of More than \$100,000. The organization must state the total number of individuals who received more than \$100,000 in reportable compensation from the organization. Form, at Part VII(A)(2).

10. Individuals Who Must be Reported on Schedule J. The organization must affirm whether it listed any of the following persons in Section A:

- Any former officer, director or trustee, key employee, or highest compensated employee;

- Any individual whose sum of reportable compensation and other compensation from the organization and related organizations is greater than \$150,000.
- Any person who received or accrued compensation from an unrelated organization for services rendered to the organization. *Id.*, at Part VII(A)(3)-(5).

Schedule J must be completed for each of those persons. *Id.*

B. Section B: Five Highest Compensated Independent Contractors

1. Identity. The organization must disclose its five highest compensated independent contractors who received more than \$100,000 in compensation from the organization. *Id.*, at Part VII(B)(1). Management companies are considered independent contractors. Instructions, at Part VII(B).

2. Services. The organization must provide a description of the services rendered by the independent contractors and the amount the organization paid to the contractor. Form, at Part VII(B)(1).

3. Total. The organization must state the total number of independent contractors who received more than \$100,000 in reportable compensation from the organization. *Id.*, at Part VII(B)(2).

C. Impact on Governance

1. Part VII and Schedule J are not directly related to governance. The questions are designed to uncover information concerning potential excess benefit transactions arising from compensation. The individuals who must be listed in Part VII are either per se disqualified persons (*e.g.*, directors) or are potentially disqualified persons (*e.g.*, definition of key employee is similar to definition of disqualified person). *See* Treas. Reg. § 53.4958-3. The information about compensation that must be reported tracks the definition of compensation for section 4958 purposes. *See* Treas. Reg. § 53.4958-4.

2. Hiring, determining the compensation, and evaluating the performance of the CEO is recognized as one of the primary roles of the board of directors. The questions on the Form 990 concerning compensation combined with the questions concerning board review of the Form 990 will likely increase the involvement of boards in compensation decisions below the CEO level. Questions concerning whether the organization follows the procedures required to obtain the rebuttable presumption of reasonableness may lead to more boards following these procedures. These procedures describe a process that comports with good governance—(1) recusal of directors who have a conflict of interest; (2) reliance on pertinent facts and perhaps professional advice in decision making; and (3) minutes of the meetings.

V. Schedule J: Compensation Information

A. Benefits

1. **Disclosure.** The organization must state whether it provided the following benefits to or for any officers, directors, trustees, key employees and five highest compensated employees listed in Part VII, Section A (“Listed Persons”):

- First-class or charter travel;
- Travel for companions;
- Tax indemnification and gross-up payments;
- Discretionary spending account;
- Housing allowance or residence for personal use;
- Payments for business use of personal residence;
- Health or social club dues or initiation fees; or,
- Personal services (*e.g.*, maid, chauffeur, chef). I.R.S. Form 990 Schedule J (hereinafter “Schedule J”), Part I(1)(a) (2008).

2. **Policy.** If any of the named benefits were provided to Listed Persons, the organization must state whether it followed a written policy regarding the payment, provision, or reimbursement of the benefits. *Id.*, Part I(1)(b). If a written policy was not followed, the organization must disclose who determined that the benefits would be provided, and explain the decision-making process. *Id.*, Part I(1)(b); Schedule J Instructions, Part I(1)(b) (2008).

3. **Substantiation.** The organization must state whether it required the Listed Persons who received the named benefits to substantiate their expenses before they were allowed or reimbursed. Schedule J, at Part I(2).

4. **Impact on Governance.** These questions are drawn from high profile examples of nonprofit executives who received the listed benefits or similar benefits without the knowledge of the full board or directors. By asking whether there is a policy for such benefits and, if not, who makes the decisions, the Service is encouraging organizations to adopt policies for such benefits and encouraging boards to oversee the provision of such payments.

B. Methods of Establishing Compensation

1. **Check Box.** The filing organization must check a box to disclose whether it used certain methods to establish the compensation of the organization’s CEO/Executive Director. *Id.*, at Part I(3). The methods listed are as follows:

- A board compensation committee, regardless of whether such a committee has ultimate authority to execute an employment agreement;
- An independent compensation consultant;
- Form 990 or other comparable organizations;
- A written employment agreement;
- A compensation survey or study of comparable organizations; and,
- Approval of an ultimate decision by the board or compensation committee as to (1) whether to enter into an employment agreement with the top management official, and (2) the terms of the agreement. *Id.*

2. Rebuttable Presumption. This section elicits information concerning the filing organization's compliance with the rebuttable presumption of reasonableness.

C. Miscellaneous Compensation

1. Plans. The filing organization must disclose whether any Listed Person received payments from the organization, or a related organization, under any of the following arrangements, or participated in the following plans, regardless of whether they received any payments under the plan:

- Severance pay;
- Change of control pay;
- Supplemental nonqualified retirement plans, defined as a plan established, sponsored, or maintained by the organization, or any related organization, that is not generally available to all employees, but is available only to a certain class or classes of management or highly compensated employees; or,
- An equity based compensation plan sponsored by the organization, or any related organization. *Id.*, at Part I(4); Schedule J Instructions, at Part I(4). Equity based compensation includes stock, stock options, stock appreciation rights, restricted stock, and phantom or shadow stock. Schedule J Instructions, at Part I(4)(c). Compensation that is contingent on the revenues or net earnings of the organization is not included. *Id.*

2. Disclosure. The organization must disclose the name of any Listed Persons who received such payments or who participated in such plans during the year; the amounts paid to each person; and the terms and conditions of any of the arrangements in which listed persons participated. *Id.*, at Part I(4)

D. Additional Information Required for 501(c)(3) and 501(c)(4) Organizations

1. Compensation Contingent on Revenues. The organization must state whether it paid or accrued any compensation with respect to a listed person that was determined in whole or in part by the gross or net revenues of one or more activities of the organization (or a related organization), or of the organization (or a related organization) as a whole. Schedule J, at Part I(5); Schedule J Instructions, at Part I(5). Any such arrangement must be described in detail. Schedule J, at Part I(5).

2. Compensation Contingent on Net Earnings. The organization must state whether it paid or accrued any compensation with respect to a listed person that was determined in whole or in part by the net earnings of one or more activities of the organization (or a related organization), or of the organization (or a related organization) as a whole. Schedule J, at Part I(6); Schedule J Instructions, at Part I(6). Any such arrangement must be described in detail. Schedule J, at Part I(6).

3. Other Non-Fixed Payments. The organization must also describe any non-fixed payment other than compensation contingent on revenues or net earnings with respect to a listed person. Schedule J, at Part I(7). Non-fixed payments are defined as payments that are not an amount of cash or other property specified in the contract, nor determined by a fixed, non-discretionary, formula specified in the contract. Schedule J Instructions, at Part I(7). Amounts payable pursuant to a qualified pension, profit-sharing, or stock bonus plan under § 401(a), or pursuant to an employee benefit program that is subject to and satisfies coverage and nondiscrimination rules under the Internal Revenue Code are treated as fixed payments, and therefore, are not required to be reported. *Id.*

4. Initial Contracts. The organization must state whether any of the amounts reported in Form 990 were paid or accrued pursuant to an “initial contract” as defined by Treasury Regulation 53.4958-4(a)(3). Schedule J, at Part I(1)(9). Any such arrangement must be described in detail. *Id.*

E. Total Compensation of Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1. Persons Covered. The organization must list the compensation for the calendar year paid to or earned by the following persons:

- The organization’s former officers, former directors or trustees, former key employees, and former five highest compensated employees;
- The organization’s current officers, directors or trustees, key employees, and five highest compensated employees

for whom the sum of his or her reportable compensation from the organization and related organizations, and any other compensation from the organization and related organizations is greater than \$150,000; and,

- The organization’s former and current officers, directors or trustees, key employees, and five highest compensated employees who received or accrued compensation for services rendered to the organization from an unrelated organization. Schedule J, at Part II; Schedule J Instructions, at Part II.

No one should be listed in this section unless he or she was listed in Form 990, Part VII. Schedule J Instructions, at Part II.

2. Compensation. Compensation that must be listed includes base compensation; bonus and incentive compensation; “other compensation”; deferred compensation; and, non-taxable benefits. Schedule J, at Part II. Any payments included in the W-2 or 1099-MISC for the tax year that were already reported on a prior Form 990, 990-EZ, or 990-PF as compensation for the listed person must be reported. Schedule J Instructions, at Part II.

VI. Schedule L: Transactions with Interested Persons

A. Overview

The Service is on firm ground in asking about transactions with interested persons because such transactions may constitute excess benefit transactions or private inurement. From a more general governance standpoint, transactions with interested persons almost always present conflict of interest issues and organizations should follow their conflict of interest policies in resolving them. Additionally, if the transactions are significant, they should be presented to the board for approval. These questions should heighten the awareness of organizations and their boards and may be viewed by organizations as a checklist of transactions that should always be reviewed under the organization’s conflicts policy. Organizations may want to develop policies or guidelines as to when, if ever, the organization will be permitted to enter into transactions with interested parties. State law may include provisions concerning such transactions and should be reviewed.

B. Part I: Excess Benefit Transactions

1. Applicability. This section must be completed only by section 501(c)(3) and (c)(4) organizations because they are the only organizations subject to the excess benefit transaction provisions of section 4958.

2. Definitions

a. An “excess benefit transaction” is defined as any transaction in which an organization provides directly or indirectly an economic benefit, the value of which

exceeds the value of the consideration received by the organization for providing such benefit, to or for the use of a disqualified person. I.R.S. Form 990 Schedule L Instructions, Part I(1) (2008) (hereinafter “Schedule L Instructions”); *see also* I.R.C. § 4958(c)(1).

b. A “disqualified person” is defined as any person who was, at any time during the 5-year period ending on the date of a transaction, in a position to exercise substantial influence over the affairs of the organization, or such a person’s family member or 35% controlled entity; the donor or donor advisor to a donor advised fund; and the investment advisor of a sponsoring organization. I.R.S. Form 990 Glossary; *see also* I.R.C. § 4958(f)(1).

3. Correction. Disqualified persons who engage in excess benefit transactions must “correct” the transaction and pay a 25% excise tax on the portion of the benefit received that is excessive. *See* I.R.C. § 4958(a)(1). Organizations that discover excess benefit transactions should take prompt action to ensure that the disqualified person makes correction and to develop preventive measures to prevent future excess benefit transactions. *See* Treas. Reg. § 1.501(c)(3)-1 (impact of excess benefit transactions on tax-exempt status).

4. Disclosure. For each excess benefit transaction, regardless of the dollar amount, the organization must provide the following information:

- The identity of the disqualified person or persons who received an excess benefit;
- The identity of any organization manager who participated in the transaction, knowing that it was an excess benefit transaction;
- A description of the transaction;
- Whether the transaction has been corrected;
- The amount of taxes imposed under section 4958 (Taxes on Excess Benefits Transactions) on organization managers and disqualified persons, whether or not assessed by the IRS; and,
- The amount of tax that was reimbursed by the organization. I.R.S. Form 990 Schedule L, Part I(1)-(3) (2008) (hereinafter “Schedule L”); Schedule L Instructions, at Part I(1)-(2).

C. Part II: Loans to and/or From Interested Persons

1. Disclosure. The filing organization must disclose all loans, including advances, between the organization and an interested person that are outstanding as of the end of the organization’s tax year. Schedule L, at Part II; Schedule L Instructions, at Part II. The disclosure must include loans originally between the organization and an interested person, and loans originally between the organization or an interested person and a third party which were

transferred so as to become debt outstanding between the organization and an interested person. Schedule L Instructions, at Part II.

2. Data Required. The organization must disclose the following information:

- The identity of the interested person involved in the transaction;
- The organization's purpose for engaging in the transaction;
- The original loan principal;
- The balance due at the end of the organization's tax year;
- Whether any payment of the debtor was past due or if the debtor is otherwise in default;
- Whether the board approved the loan transaction; and,
- Whether the loan is evidenced by a promissory note or other written agreement signed by the debtor. Schedule L, at Part II.

3. Interested Person. For the purposes of this Part, "interested person" is defined as current or former officers, directors or trustees, key employees, and the five highest compensated employees. Schedule L Instructions, at Part II. For 501(c)(3) or (4) organizations, disqualified persons are also considered "interested persons." Schedule L Instructions, at Part II; *see also* I.R.C. § 4958(f)(1). For 509(a)(3) organizations, supporting organizations are also considered "interested persons." Schedule L Instructions, at Part II; *see also* I.R.C. § 4958(c)(3)(B).

4. Influences. Note that many state laws prohibit or restrict loans by nonprofit organizations to officers and directors. Moreover, because SOX prohibits loans from public companies to their officers and directors, *see* SOX § 402, 15 U.S.C. 78 *et seq.*, such loans tend to be viewed as indicators of poor corporate governance. If a tax-exempt organization does make a loan to an officer or director, the loan should be approved by the board of directors, evidenced by a written promissory note, and should be subject to a market interest rate for comparable loans. If the loan is not subject to market interest rates, the value of the benefit of the below market interest rate should be reported as income. *See* I.R.C. § 7872.

D. Part III: Grants or Assistance Benefitting Interested Persons

1. Overview. The filing organization must report all grants, including scholarships, fellowships, internships, prizes, and awards, and other assistance, including provision of goods, services, or use of facilities, regardless of amount, that it provided to any interested person. Schedule L, at Part III; Schedule L Instructions, at Part III.

2. Disclosure. The organization must disclose the following information:

- The identity of the interested person who benefited from the grant or assistance;
- The type of relationship between the interested person and the organization; and,
- The dollar amount of the grant, or a description of the type of assistance and its estimated value. Schedule L, at Part III.

3. Interested Person. For the purposes of this Part, “interested person” is defined as current or former officers, directors, trustees, key employees, substantial contributors and related persons. Schedule L Instructions, at Part III.

a. A “substantial contributor” is defined as a person that contributed at least \$5,000 and is required to be reported by name in Form 990, Schedule B. Schedule L Instructions, at Part III.

b. A “related person” is defined as follows:

- A member of the organization’s grant selection committee;
- A family member of any of the organization’s current or former officers, directors, trustees, or key employees;
- A 35% controlled entity of any of the organization’s current or former officers, directors, trustees, or key employees;
- An employee, or child of an employee, of a substantial contributor or of a 35% controlled entity of a substantial contributor, if the grant or assistance was provided by the direction or advice of the substantial contributor or 35% controlled entity, or pursuant to a program funded by the substantial contributor that was intended primarily to benefit such employees or their children. Schedule L Instructions, at Part III.

4. Standard of Diligence

a. The filing organization must make a “reasonable effort” to obtain the information about grants or assistance to an interested persons. *Id.*

b. An example of a reasonable effort provided by the IRS in the Instructions is sending out an annual survey to each listed person and each member of a grant selection committee that includes the reporting person’s name, title, date, signature, and the instructions and definitions relevant for determining whether a listed person received a grant or assistance. *Id.*

i. Substantial contributors and persons related to a substantial contributor are not expected to be surveyed, unless that person “advises the organization as to the specific recipients of grants or assistance, or with respect to programs of the organization intended primarily to benefit employees (or their children) of the substantial contributor or their 35% controlled entities.” *Id.*

5. Safe Harbor. Grants or other assistance benefiting interested persons may evidence excess benefit transactions or private inurement and should generally be avoided. Grants to a substantial contributor’s employees (and their children) that are awarded on an objective and nondiscriminatory basis based on pre-established criteria and review by a selection committee, as described in Treasury Regulation section 53.4945-4(b) need not be reported.

E. Part IV: Business Transactions Involving Interested Persons

1. Overview. The organization must report all business transactions for which payments were made during the organization’s tax year between the organization and an interested person that exceed one of the following thresholds:

- All payments between the organization and the interested person that exceed \$100,000;
- All payments from a single transaction between the organization and the interested person that exceed the greater of \$10,000 or 1% of the filing organization’s total revenues; or,
- Compensation payments by the organization paid to a family member of a current officer, director, trustee, or key employee of the organization that exceed \$10,000.
Schedule L, at Part IV; Schedule L Instructions, at Part IV.

2. Disclosure. The organization must disclose the following information:

- The identity of the interested person involved in the business relationship with the organization;
- The type of relationship between the interested person and the organization; and,
- The cash amount of the transaction or fair market value of the assets or services provided by the organization;
- The type of transaction; and,
- Whether all or part of the consideration paid by the organization was based on a percentage of revenues of the organization.
Schedule L, at Part IV.

3. Business Transactions. “Business transactions” include, but are not limited to, contracts of sale; leases; licenses; performance of services; joint ventures, whether new or ongoing, in which either the profits or capital interest of the organization and of the interested person each exceed 10%; and, transactions between the organization and a management company of which a former officer, director, trustee, or key employee of the organization within the last five tax years is a direct or indirect 35% owner, officer, director, trustee, or key employee. Schedule L Instructions, at Part IV.

4. Interested Person. For the purposes of this Part, “interested person” is defined as follows:

- A current or former officer, director, trustee, or key employee, or their family members;
- An entity more than 35% owned, directly or indirectly, individually or collectively, by current or former officers, directors, trustees, or key employees, or their family members;
- An entity, other than a 501(c), of which a current or former officer, director, trustee, or key employee was serving at the time of the transaction as an officer; director; trustee; key employee; partner or member with an ownership interest in excess of 5%, if the entity is treated as a partnership; or, a shareholder with an ownership interest in excess of 5%, if the entity is treated as a professional corporation. Schedule L Instructions, at Part IV.

5. Standard of Diligence

a. The organization must make a “reasonable effort” to obtain the information about business transactions with interested persons. *Id.*

b. An example of a reasonable effort provided by the IRS in the Instructions is sending out an annual survey to each listed person that includes the reporting person’s name, title, date, signature, and the instructions and definitions relevant for determining whether the person engaged in interested transactions with the organization. *Id.*

c. To perform the required due diligence, a survey does not have to be sent to organizations or individuals with which the organization does business, but who are not current or former officers, directors, trustees, or key employees of the organization. *Id.*

6. Scrutiny. Business transactions with interested persons will be subject to scrutiny. Organizations that enter into such transactions should follow their conflict of interest policies and, if the transaction is significant, should follow the requirements for the rebuttable presumption of reasonableness under section 4958. *See* Treas. Reg. § 53.4958-6.

VII. Schedule O: Supplemental Information for Form 990

Schedule O is used to provide narrative responses to questions on Form 990. Particular questions on the Core Form 990 and four of the Form 990 schedules require a narrative response. However, an organization may use Schedule O to explain its operations and practices or to provide supplemental information for any question. I.R.S. Form 990 Schedule O Instructions, General Instructions.