

FORM 990: Items to be Aware of...

DOUGLAS M. LEDERMAN, CPA
VP, Director and Senior
Tax Partner

**Gorfine, Schiller
& Gardyn, P.A.**
10045 Red Run Blvd.
Owings Mills, MD
(410) 356-5900
dlederman@GSGcpaonline.com



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SEMINAR

Breakfast Seminar
8—11 A.M. Tuesday, September 25th, 2007
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Part III – Statement of Service Accomplishments

- Exempt Purpose
- Achievements



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Risks of Form

- IRS risk
 - Penalties: “General” and “Special”
 - Unexpected Tax Liability
 - Loss of Exempt Status
- Studied also by:
 - Philanthropists: Time and Money Risk
 - Grantmaking Organizations almost always require 990
 - Journalists: Bad Press Risk
 - Mandatory Public Disclosure
 - Do-gooders
 - Guidestar



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IRS Scrutiny Increasing

- '04: New compliance unit for 990 returns e.g. first letters went out to orgs having donations but no fundraising expense
- '06: Audits up 43%; 7079 returns audited; 600% increased resources. Form 1023 revised again

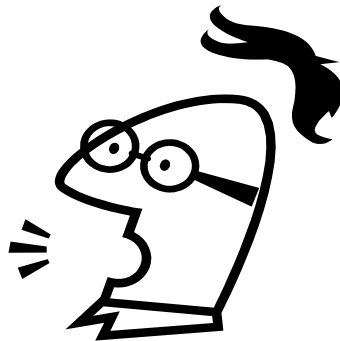


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The “General” Penalty: Incomplete Return Penalty

- Can be imposed against both the organization and all responsible persons
- Organization: \$20/day (max of \$10K or 5% of receipts).
5x that if revenues >\$1Mil.
- Responsible Persons: \$10/day (max of \$5K, total)



Crucial 990 Items: Definition

- Incomplete return is “failure to file” IF material info omitted hinders IRS
 - This is subject to penalty
 - Revocation of Status (Rev Rul 59-95)
 - 6501(c)(3) Unlimited Assessment Period
- This includes Schedules A, B



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Electronic Filing Failure = an Incomplete Return



When Required?

ONLY if \$10M assets and 250 info returns (incl. payroll)
(Down from \$100M for '05)

- Q. HUGE, a not for profit, finds itself with \$10 Million in assets at the end of its year, December, 2006, down from \$99 Million just a year ago. Like last year, the professional fundraiser, plus 6 others, receive 1099s . HUGE employs 238 people.
- A. HUGE is required to e-file for '06 but was not required in '05. (238 W-2s +4 941s +the fundraiser's 1099 +6 other 1099s +the 990 =250 returns).

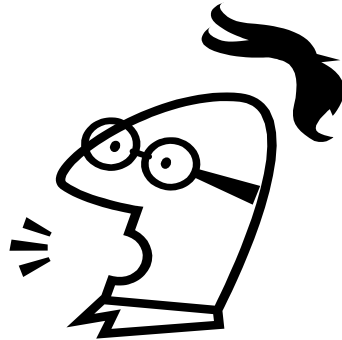


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The “Special” Penalties: From the New Laws

- Can be imposed against both the organization and all responsible persons
- Tax Shelter Participation
- Donor Advised Funds
- Supporting Organizations



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Officers, Directors, Trustees, and Key Employees Relationships and Related Compensation

- The Guise: Form 990, p.6, lines 75b and 75c. Also, p. 2, lines 25a-c, p. 4, lines 50a-b, and p. 5 part V-A. Also, for 501(c)(3)s, Schedule A, Parts I and II.
- Who Needs to Know: ALL nonprofits.
- The Special Risks: Revocation of Nonprofit Status and Excess Benefit Penalty
- Action Needed: Due diligence for ascertaining relationships amongst “keypersons” and between keypersons and “related organizations.” Verify the info is being reported. DOCUMENTATION!



Officer/Director Compensation QUESTION

Q.: NFP asks its outside accountants, HTH, for its advice. One of its Board of Directors, Bea, a network specialist by training, also “volunteered” recently to replace the outside computer person, who “just wasn’t living up to expectations.” Bea said she would do this after-hours so as not to interfere with the usual running of the operations and would not charge more than the previous computer person. She bills the company through her wholly-owned LLC, Bea’s LLC. NFP just wants HTH to confirm that these payments to Bea are reported as computer expense on the 990. What should HTH say?

A.: No, the payments, rather, are included as officer/director compensation expense on p. 2 and in Part V.



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Background: Loans to Key Persons

Lines 50a-b

- Loans to key people reported separately (includes former key persons)
- These, like most loan receivables and payables, require detailed attachments, including payment terms and security provided
- High proportion is an IRS flag for investigating impermissible private benefit to insiders
- Incomplete return penalties explicitly apply for burying these; terms must be given



Key Employees Definition

- Any employee having authority to control the organization's activities and/or its finances
- Typically: Executive Director, Chief Financial Officer, Director of Operations and the like
- Usually not: Department or Program Heads



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Officers, Directors, Trustees, and Key Employees

Line 75b Reporting Relationships

- Relationships to report: if any current keyperson related to another keyperson*
 - Family: spouse, and all direct ancestors and descendants, and all siblings and half-siblings, and spouses of these
 - Business: employee, contractor, or “common owner”
 - Common owner: owning more than 35%
 - Corporate vote, partnership profits interest, or trust beneficial interest
 - The 35% can be reached in combination
- * For 501(c)(3)s, a keyperson also includes highly compensated personnel and contractors, i.e. \$50,000 or more, which are listed on Schedule A, Parts I and II



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Officers, Directors, Trustees, and Key Employees Line 75b Relationships

QUESTION

- Question: There are 7 members comprising the Board of NFP, reported on Part V and 7 unrelated employees earning more than \$50,000, reported on Schedule A Part I. Each Board member is an uncle of a different highly compensated employee. The only one reportable independent contractor (professional) reported on Sch A, Part II-A is the accounting firm HTH which charged a \$50,001 fee. Each of three of the Board members and four of the highly compensated employees, none of which are nephews of the these three Board members, bought a 5% voting stock share in TCN Corp at different times long ago and long before any had a connection to NFP. TCN has nothing to do with NFP. Disclose the relationships.



Officers, Directors, Trustees, and Key Employees Line 75b Relationships

ANSWER

- Answer:
- Family- None
- Business- The 7 shareholders of TCN are reportable as common owners of TCN.
- Note that *it seems that* if one of the employee's spouses owned the 5%, nothing would be reportable.



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Officers, Directors, Trustees, and Key Employees Line 75b Relationships

The Required Due Diligence

- Need to make a reasonable effort to ascertain
- Per IRS, “reasonable effort”: Distribute to each keyperson* the definition of relationships (see previous slides) and the 990 Part V-A list of keypersons** so that each one can answer

* for a 501(c)(3), a keyperson includes highly compensated persons and independent contractors, which are listed on the Schedule A Parts I and II

** for a 501(c)(3), also distribute the Schedule A Parts I and II lists of “highly compensated”



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Officers, Directors, Trustees, and Key Employees

Line 75c Related Organization

Compensation

- Purpose: Choose auditees for excessive comp audit; if necessary, reallocate comp expense amongst entities; revoke exempt status of organizations deemed to be providing private benefits to keypersons. (IRS wants to see how these key and highly compensated people earn their total compensation in the 990 related group.)
 - When to Report: When any reported keyperson* earns \geq \$50,000 after combining the amounts paid by the 990 entity with all compensation-paying related entities of the 990 entity. Includes all entities even for-profit.
 - Highly controversial due of invasion of privacy (vis a vis the public)
 - IRS insists that they have right but has now listed certain limited reporting exceptions (see Exceptions Slide)
- * for a 501(c)(3), a keyperson includes highly compensated persons and independent contractors, which are listed on the Schedule A Parts I and II



Officers, Directors, Trustees, and Key Employees Line 75c Related Organization Compensation Definition

- “Related Organization”:
 - When the 990 entity (plus any other related entities) owns \geq 50% stock or profits, beneficial interest of an entity
 - Common 50% keypersons or the 990 entity appointing such (or being appointed)
 - Common substantial influence
 - Supporting, benefiting or furthering purpose of organization
 - The 990 entity has authority to approve budgets (or its budget approved)
 - Coordination of operations (facilities, employees, etc) between the entities



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Officers, Directors, Trustees, and Key Employees

Line 75c Related Organization Compensation

Substantial Influence

- “Substantial influence”
 - Not clear; uses indicators:
 - Founder
 - Any combination of persons to control substantially budgets or employee compensation, including the manager of a discrete business segment representing a substantial portion of the activities, income, expense, assets
 - Anyone whose compensation is primarily based on revenues from activities of the organization under the person’s control
 - A “substantial contributor” to organization over past 5 years
Owning a controlling interest in an entity (corp, pship, trust) that is a disqualified person



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Officers, Directors, Trustees, and Key Employees Line 75c Related Organization Compensation

- Other Points:
 - Only for period when relationship existed
 - During the 990 tax year
 - Include all amounts that would be reported on Form 990, Part V-A (only from relateds that paid).



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CONCLUDING NOTE: GOVERNANCE

The IRS announced on Feb. 2 '07 that despite the limits on its *formal* powers, the IRS intends to assess whether exempt organizations are adopting governance measures, to stop “unfettered decisionmaking authority with little public exposure.”

The IRS added: “As important as it is that Board members be passionate about their organization’s programs, it is equally important that they have expertise in critical areas, such as accounting, finance, compensation and ethics.”
(continued)



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CONCLUDING NOTE: GOVERNANCE

The IRS published its specific governance recommendations:

- Adoption of a mission statement
- Use of a code of ethics; a whistleblower policy
- Board to exercise due diligence in ensuring they are sufficiently informed to fulfill their duty
- Board conflict of interest policy
- “Transparency”: full and accurate info to Board, regulators, and the public
- Truthful fundraising activities
- Enhanced financial auditing, i.e. use of audit committees; rotating outside auditors
- Compensation decision controls, ensuring documentation and comparability studies
- Document retention policies to ensure info can be maintained and is available



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