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# CHAPTER ONE

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## Part I—Overview of New Form 990

The annual information return filed by most tax-exempt organizations with the Internal Revenue Service (IRS) is the Form 990. This return was issued in dramatically redesigned form on December 19, 2007, for the 2008 tax year (returns filed in 2009). In its altered form, the new Form 990 has enormous implications for exempt organizations. A copy of this return, including its many schedules, is in Appendix A.

At the time the revised Form 990 was issued as a discussion draft (on June 14, 2007), the Acting Commissioner of Internal Revenue said: “The tax-exempt sector has changed markedly since the Form 990 was last overhauled more than a quarter of a century ago. We need a Form 990 that reflects the way this growing sector operates in the 21st century. The new 990 aims to give both the IRS and the public an improved window into the way tax-exempt organizations go about their vital mission.”

The Director of the IRS’s Exempt Organizations Division, on that occasion, added: “Most organizations should not experience a change in burden. However, those with complicated compensation arrangements, related entity structures and activities that raise compliance concerns may have to spend more time providing meaningful information to the public.”

When the new Form 990 was released in final form, the Commissioner, Tax Exempt/Governmental Entities, said: “When we released the redesigned draft form this past June, we said we needed a Form 990 that reflects the way this growing sector operates in the 21st century. The public comments we received in response to our draft form helped us develop a final form consistent with our guiding principles of transparency, compliance and burden minimization.”

The new Commissioner of Internal Revenue said:

Tax-exempt organizations provide tremendous benefits to the people and the communities they serve, but their ability to do good work hinges upon the public’s trust. The new Form 990 will foster this trust by greatly improving transparency and compliance in the tax-exempt sector. Public comment on the draft instructions will help the IRS to minimize the reporting burden on tax-exempt organizations, which is another important goal.

On the occasion of issuance of the final instructions for the 2008 Form 990, on August 19, 2008, the Commissioner said:

These instructions are the final step in a tremendous effort to bring the Form 990 up to date and to reflect the diversity and complexity of the tax-exempt community.

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The revised form will give the IRS and the public a much better view of how exempt organizations operate. The improved transparency provided by these changes will also benefit the tax-exempt community.

On the day after the draft of the revised Form 990 was issued, the executive director of a large public charity said: “If this is the Form 990 we will have to file, we don’t want to be tax-exempt anymore.”

The return to be filed by small tax-exempt organizations (Form 990-EZ) has also been revised (see § 1.9). Many of the schedules that accompany the Form 990 (see § 1.8) may have to be filed with this small exempt organizations return. (The Form 990-PF filed by private foundations has not been revised as part of this process.)

### § 1.1 FORM 990 BASICS

Nearly every organization that is exempt from federal income taxation must file an annual information return with the IRS. This return generally calls for the provision of much information, some of it financial and some in prose form. This document, being an *information return* rather than a *tax return*, is available for public inspection (see § 1.1(e)).

#### (a) Various Forms

For most tax-exempt organizations, the information return that must be filed annually is Form 990. Private foundations, however, file an information return that is uniquely styled for them: Form 990-PF. Small organizations (other than private foundations)—that is, entities that have gross receipts that are less than \$100,000 and total assets that are less than \$250,000 in value at the end of the reporting year—file Form 990-EZ. Other forms in the 990 series are Form 990-N, 990-T, and 990-W.

#### (b) Filing Exceptions

The requirement for the filing of an annual information return does not apply to:

- Churches (including interchurch organizations of local units of a church)
- Integrated auxiliaries of churches
- Conventions or associations of churches
- Financing, fund management, or retirement insurance program management organizations functioning on behalf of the foregoing organizations
- Certain other entities affiliated with a church or convention or association of churches
- Most religious orders (to the exclusive extent of their religious activities)
- State and local institutions
- Certain schools and mission societies
- Governmental units
- Affiliates of governmental units (which can include nonprofit, tax-exempt organizations)

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- Organizations (other than private foundations) that have gross receipts that normally are not in excess of \$25,000 annually
- Foreign organizations (other than private foundations) that normally do not receive more than \$25,000 in gross receipts annually from sources within the United States and that do not have any significant activity (including lobbying or political activity) in the United States

### (c) Filing Due Dates

The annual information return is due on or before the 15th day of the 5th month following the close of the organization's tax year. Thus, the return for a calendar-year organization should be filed by May 15 of each year. One or more extensions may be obtained. These returns are filed with the IRS service center in Ogden, Utah.

The filing date for an annual information return may fall due while the organization's application for recognition of tax-exempt status is pending with the IRS. In that instance, the organization should nonetheless file the information return (rather than a tax return) and indicate on it that the application is pending.

### (d) Penalties

Failure to timely file the annual information return, without reasonable cause or an exception, can generally give rise to a \$20-per day penalty. The organization must pay for each day the failure continues, up to a maximum of \$10,000. For larger organizations (those with annual gross receipts in excess of \$1 million), the per-day penalty is \$100 and the maximum penalty is \$50,000.

An additional penalty can be imposed, at the same rate and up to the same maximum, on the individual(s) responsible for the failure to file, absent reasonable cause. Other fines and even imprisonment can be imposed for willfully failing to file returns or for filing fraudulent returns and statements with the IRS.

### (e) Disclosure Requirements

The IRS, in its instructions, observes: "Some members of the public rely on Form 990, or Form 990-EZ, as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its returns."

A tax-exempt organization's completed Form 990 or Form 990-EZ is available for public inspection and disclosure. Schedule B (see § 1.8(b)) is generally not available for public inspection, although it is available in the case of political organizations that file either return (and private foundations). Form 990-T filed by a charitable organization after August 17, 2006, to report unrelated business income, is also available for public inspection and disclosure.

**(1) Availability through IRS.** Form 4506-A may be filed to request (1) a copy of a tax-exempt organization's return, report, notice, or application for recognition of exemption, and/or (2) an inspection of a return, report, notice, or application at an IRS office.

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**(2) Availability through Exempt Organization.** In general, a tax-exempt organization must:

- Make its application for recognition of exemption and its annual information returns available for public inspection without charge at its principal, regional, and district offices during regular business hours
- Make each annual information return available for a period of three years, beginning on the date the return is required to be filed or is actually filed, whichever is later
- Provide a copy without charge, other than a reasonable fee for reproduction and actual postage costs, of all or any part of any application or return required to be made available for public inspection to any individual who makes a request for such copy in person or in writing

A tax-exempt organization must:

- Provide copies of required documents in response to a request made in person at its principal, regional, and district offices during regular business hours
- Provide these copies to a requester on the day the request is made, except for unusual circumstances

In the case of an in-person request, where unusual circumstances exist so that fulfilling the request on the same business day causes an unreasonable burden to the tax-exempt organization, the organization must provide the copies no later than the next business day following the day that the unusual circumstances cease to exist or the fifth business day after the date of the request, whichever occurs first. *Unusual circumstances* include requests received (1) that exceed the organization's daily capacity to make copies, (2) shortly before the end of regular business hours that require an extensive amount of copying, or (3) on a day when the organization's managerial staff capable of fulfilling the request is conducting special duties, such as student registration or attending an off-site meeting or convention.

A tax-exempt organization may charge a reasonable fee for providing copies. Before the organization provides the documents, it may require that the individual requesting the copies pay the fee. If the organization has provided an individual making the request with notice of the fee, and the individual does not pay the fee within 30 days, or if the individual pays the fee by check and the check does not clear, the organization may disregard the request.

A tax-exempt organization is not required to comply with a request for a copy of its application for recognition of exemption or an annual information return if the organization has made the requested document widely available. (It must nonetheless comply with the public inspection rules.) This *widely available* requirement is satisfied by posting the document on a Web site that the exempt organization maintains or on a Web site maintained by another organization where:

- The Web site clearly informs readers that the document is available and provides instructions for downloading it.
- The document is posted in a format that, when accessed, downloaded, viewed, and printed in hard copy, exactly reproduces the image of the application for

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recognition of exemption or annual information return as it was originally filed with the IRS (except for any information permitted by statute to be withheld from public disclosure).

- An individual with access to the Internet can access, download, view, and print the document without special computer hardware or software required for that format and without payment of a fee to the exempt organization or another entity maintaining the Web site.

If the Director, Exempt Organizations Examination (or a designee) determines that a tax-exempt organization is being harassed, the organization is not required to comply with any request for copies that it reasonably believes is part of a harassment campaign. Whether a group of requests constitutes a harassment campaign depends on the relevant facts and circumstances, such as a sudden increase in requests, an extraordinary number of requests by form letters or similarly worded correspondence, hostile requests, evidence showing bad faith or deterrence of the organization's exempt purpose, and a demonstration that the organization routinely provides copies of its documents on request. An exempt organization may disregard any request for copies of all or part of any document beyond the first two received within a 30-day period or the first four received within a one-year period from the same individual or the same address, irrespective of whether the IRS has determined that the organization is a victim of a harassment campaign.

### § 1.2 IRS GUIDING PRINCIPLES

The IRS said that its retooling of this annual information return was based on these guiding principles:

- Enhancing transparency by providing the IRS and the public with a realistic picture of the filing organization and its operations, along with the basis for comparing the organization to similar organizations
- Promoting compliance, by designing a return that accurately reflects the organization's operations and use of assets, thereby enabling the IRS to more efficiently assess the risk of any noncompliance by the organization
- Minimizing the burden on filing organizations, by asking questions in a manner that makes it relatively easy to prepare the return and not impose unwarranted record-keeping or information-gathering burdens to obtain and substantiate the reported information

### § 1.3 IMPORT OF NEW FORM 990

The redesigned Form 990 is no ordinary information return and, for that matter, is no ordinary government form. This is a significant, complex, and extraordinary document. It is, in many ways, a work of art, in that it captures the requirements of a large amount of statutory law, much of it recently enacted. At the same time, because of its size and complexity, many organizations will be engaging in considerable effort (time and money) to create needed documents, maintain records, and properly prepare and timely file the return.

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From a law perspective, the new return has, as noted, enormous implications for tax-exempt organizations, for two reasons.

1. The form in various places and ways has the effect of creating much new law. A dramatic example of this fact is the portion on governance (see Chapter 5).
2. The form is designed to induce certain behavior by the management of non-profit, tax-exempt organizations by in essence forcing organizations to check “yes” boxes (or avoid checking “no” boxes). The import of this “shaming technique” can be seen, for example, in the requirements as to development of various policies and dissemination to the public of various documents.

### § 1.4 NEW FORM 990 INTRODUCTION

The introduction to the new Form 990 requests this information:

- Item A.** The tax year of the organization, which is either the calendar year (2008) or a fiscal year (a year that began in 2008).
- Item B.** An indication, by checking one or more boxes, as to whether there has been an address change, a name change, the return is the initial return, the organization has been terminated (so that the return is the final return), the return is an amended return, and/or the filing organization’s application for recognition of exemption (usually Form 1023 or 1024) is pending with the IRS.
- Item C.** The name of the organization, any other name in which it is doing business, and the organization’s address where mail is delivered.
- Item D.** The organization’s employer identification number.
- Item E.** The organization’s telephone number.
- Item F.** The name and address of the organization’s principal officer.
- Item G.** The amount of the organization’s gross receipts.
- Item H.** Information as to any group exemption, namely, whether the Form 990 is a group return for affiliates; whether all affiliates are included in the return; if all affiliates are not included, a list of those that are included (as an attachment); and the group exemption number.
- Item I.** Identification of the organization’s tax-exempt status, by reference to the appropriate section of the Internal Revenue Code.
- Item J.** The organization’s Web site address.
- Item K.** The type of the organization, such as a corporation, a trust, or an unincorporated association. This inquiry may cause some confusion, in that an incorporated association may indicate that it is an “association.”
- Item L.** The year the organization was formed.
- Item M.** The state in which the organization is legally domiciled.

If the organization has changed its name and it is a corporation, it should attach to the Form 990 a copy of the amendment to the articles of incorporation

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and proof of filing with the state of incorporation. If there was a name change and the entity is a trust, a copy of the amendment to the trust agreement or declaration of trust, signed by the trustee, should be attached. If there was a name change and the entity is an unincorporated association, a copy of the amendment to the organizing document (such as a constitution or articles of association), with the signatures of at least two officers and/or members, should be attached.

An organization that checks the box in the case of a termination is required to attach Schedule N to the return. If the organization checks the amended return box, it should attach Schedule O, stating in that schedule which part(s) and schedule(s) of the return are being amended, and a description of the amendment(s). If a change of address occurs after the return is filed, the organization should use Form 8822 to notify the IRS of the new address.

As to the telephone number (item E), the organization should enter a telephone number of the organization that members of the public and government personnel may use during normal business hours to obtain information about the organization's finances and activities. If the organization does not have a telephone number, it should enter the telephone number of an organization official who can provide that information.

As to the name and address of a principal officer (item F), the address provided must be a complete mailing address to enable the IRS to communicate with the officer if necessary. If the officer prefers to be contacted at the organization's address (item C), the entry should be: "Same as C, above." For this purpose, the term *principal officer* means an individual who, regardless of title, has ultimate responsibility for implementing the decisions of the organization's governing body, or for supervising the management, administration, or operation of the organization.

As to *gross receipts*, that amount is equal to the amount derived by adding the amounts on lines 6b (both columns), 7b (both columns), 8b, 9b, 10b, and 12, Column A of the new Form 990, Part VIII. Some organizations, because of the amount of their gross receipts, are not required to file Form 990 (see § 1.9).

If the Form 990 is a group return (item H), so that the organization answers "yes" in response to the question on line H(a), but it answers "no" to the question on line H(b), the organization should attach a list (not using Schedule O) showing the name, address, and employer identification number of each subordinate organization included in the group return. This list should (1) show the form number (Form 990) and tax year, (2) show the organization's name and employer identification number, (3) show the group exemption number, and (4) be on a piece of paper that is the same size as the Form 990 pages.

The group exemption number should be entered on line H(c) if the organization is (1) filing a group return or (2) a central or subordinate in a group exemption arrangement and is filing a separate return. The IRS's instructions caution organizations to not confuse the group exemption number (four digits) with the employer identification number (item D, consisting of nine digits).

As to the Web site address (item J), if the organization does not have a Web site, the IRS's draft instructions instruct the filing organization to enter "N/A." (This is inconsistent with several instructions accompanying the new Form 990 where, if a line or question is not applicable, the instructions state that the line is to be left blank.)

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As to the type of organization (item K), the draft instructions provide that the organization should check the box referencing the organization's "legal entity form." The choices are corporation, trust, unincorporated associations, and "other." The instructions state that *other* includes partnerships and limited liability companies. This is a bit inconsistent with the Form 1023 (*Application for Recognition of Exemption*) filed by organizations seeking recognition as charitable entities; that form allows only corporations, trusts, unincorporated associations, and limited liability companies to file it. A partnership that elects to be treated as a corporation for federal tax purposes presumably would apply for recognition of exemption as a partnership.

As to the state of legal domicile (item M), the draft instructions state that an organization should, if it is a corporation, enter the state of incorporation or, if a foreign corporation, the country of incorporation. If the organization is a trust or other entity, it should enter the state the law of which governs the organization's internal affairs or, if a foreign entity, the foreign country the law of which governs the organization.

### § 1.5 SUMMARY OF PARTS OF NEW FORM 990

The redesigned Form 990 includes an 11-page "core form." There is a one-page summary of the organization (Part I), followed by 10 additional parts (II–XI). Part II is the signature block. This core return is accompanied by 16 schedules. (See § 1.8.)

#### (a) Part I (Summary)

The summary requests, in line 1, a brief description of the organization's mission or most significant activities. The organization has the choice as to which it wishes to highlight. This summary asks for the number of voting members of the organization's governing body (line 3), the number of these board members who are independent (line 4), the number of employees (line 5), and the number of volunteers (line 6). Other questions concern the amount of contributions and grants (line 8), program service revenue (line 9), investment income (line 10), other revenue (line 11), total gross unrelated business income (line 7a), total revenue and expenses (lines 12 and 18), grants and similar amounts paid (line 13), compensation (line 15), professional fundraising expenses (line 16a), other expenses (line 17), and total assets and liabilities (lines 20 and 21). (See §§ 1.6, 1.7.)

A box is to be checked (line 2) if the organization discontinued its operations or disposed of more than 25 percent of its assets. That is, this box is to be checked if the organization answered "yes" to lines 31 or 32 of Part IV (see § 3.1(II), (mm)) and thus completed Schedule N, Parts I or II (see § 20.2(a), (b)).

As to volunteers (line 6), the organization is required to provide the number of volunteers, full time and part time, who provided services to the organization during the reporting year. Organizations that do not keep track of this information in their books and records or report this information elsewhere (such as in annual reports or grant proposals) may provide a "reasonable estimate [of this number], and may use any reasonable basis for determining this estimate." Organizations may, but are not required to, provide an explanation on Schedule O as to how this number was determined as well as the types of services or benefits provided by their volunteers.

### § 1.5 SUMMARY OF PARTS OF NEW FORM 990

As to unrelated business taxable income (line 7b), if the organization is not required to file a Form 990-T for the tax year, it should enter "0." If the organization has not yet filed Form 990-T for the tax year, it should provide an estimate of the amount it expects to report on that return (line 34) when it is filed.

Lines 8 to 19 require reporting of prior-year (2007) revenue and expense amounts. This list should be used to determine what to report on these lines for prior-year revenue and expense amounts from the 2007 Form 990:

- Contributions and grants (line 8) (2007 Form 990, Part I, line 1e)
- Program service revenue (line 9) (2007 Form 990, Part I, lines 2 and 3)
- Investment income (line 10) (2007 Form 990, Part I, lines 4, 5, and 7, less any royalties reported on line 7, and 8d)
- Other revenue (line 11) (2007 Form 990, Part I, lines 6c, 9c, 10c, and 11, plus any royalties reported in line 7)
- Total revenue (line 12) (2007 Form 990, Part I, line 12)
- Grants and similar amounts paid (line 13) (2007 Form 990, Part II, lines 22a–23, column (A))
- Benefits paid to or for members (line 14) (2007 Form 990, line 24, column (A))
- Salaries, other compensation, employee benefits (line 15) (2007 Form 990, Part II, lines 25a–28, column (A))
- Professional fundraising expenses (line 16) (2007 Form 990, Part II, line 30, column (A))
- Other expenses (line 17) (2007 Form 990, Part II, lines 29 and 31–43g, column (A))
- Total expenses (line 18) (2007 Form 990, Part II, line 44, column (A))
- Revenue less expenses (line 19) (2007 Form 990, Part I, line 18)

The IRS, in its instructions, advises organizations that, because Part I generally reflects information reported elsewhere in the new Form 990, completion of this part (Summary) should be deferred until completion of the other parts of the return. (See the sequencing list in § 1.11.)

#### **(b) Part II (Signature Block)**

To make the new Form 990 complete, an officer of the filing organization authorized to sign the return must sign it in the space provided. For a corporation or unincorporated association, this officer may be the president, vice president, treasurer, assistant treasurer, chief accounting officer, or other corporate or association officer, such as a tax officer. A receiver, trustee, or assignee must sign any return her or she files for a corporation or an association. For a trust, the authorized trustee(s) must sign the return.

Generally, anyone who is paid to prepare the return must sign in the Paid Preparer's Use Only area. The paid preparer must (1) sign the return in the space provided for the preparer's signature, (2) enter the preparer information (other than the preparer taxpayer identification number and the employer identification number blocks, except as described next), and (3) provide a copy of the return to the organization.

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The paid preparer, however, must enter the preparer taxpayer identification number and the preparer's firm's employer identification number only if filing the Form 990 for a nonexempt charitable split-interest trust that is not filing Form 1041. The paid preparer's space is to be left blank if a regular employee of the filing organization prepared the return.

On the last line of Part II, the organization should check the "yes" box if the IRS may contact the paid preparer who signed the return to discuss the return. By checking this box "yes," the organization is authorizing the IRS to contact the paid preparer to discuss any matter relating to this return. The "no" box is to be checked if the IRS is to contact the organization or its principal officer (listed in item F of the introduction (heading) (see § 1.4)) rather than the paid preparer.

**(c) Part III (Program Service Accomplishments)**

Part III of the redesigned Form 990 concerns the filing organization's program service accomplishments. It is required to describe its mission, new significant program services, any significant changes in the way it conducts a program, a cessation of any activity, and the exempt purpose achievements for each of its three largest programs services by expenses. Charitable and social welfare organizations are required to report the amount of grants and allocations to others, total; expenses; and any revenue for each program service reported. (See Chapter 2.)

**(d) Part IV (Schedules)**

Part IV of the redesigned Form 990 is a checklist of (potentially) required schedules. This schedule references 44 questions and 16 schedules. (See Chapter 3.)

**(e) Part V (Other IRS Filings)**

Part V of the Form 990 pertains to a variety of activities and IRS filings. As to activities, there are questions about unrelated business income, involvement in a prohibited tax shelter transaction, use of supporting organizations, use of donor-advised funds, and payments with respect to personal benefit contracts. As to IRS filings, there are questions about the filing of seven forms (990-T, 1096, 1098-C, 8282, 8886-T, W-2G, and W-3). (See Chapter 4.)

**(f) Part VI (Governance)**

Part VI of the Form 990 concerns governance, management, policies, and disclosure. As to the governing body and management (Section A), questions concern the number of the voting members of the governing body and the number of board members who are "independent." Inquiry is made as to whether the organization has conflict-of-interest, whistleblower, and document retention and destruction policies, as well as policies governing the activities of chapters, affiliates, and "branches" (Section B). Additional questions pertain to various disclosures (Section C). (See Chapter 5.)

**(g) Part VII (Compensation)**

Part VII of the Form 990 focuses on compensation of insiders and independent contractors. The persons currently in their positions must be listed (irrespective of

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compensation), along with a list of the organization's five highest-compensated employees (other than insiders) who received compensation of more than \$100,000 from the organization and any related organizations during the year; the organization's former officers, key employees, or highest-compensated employees who received more than \$100,000 of compensation from the organization and any related organizations during the year; and the organization's former directors or trustees who received (in that capacity) more than \$10,000 of compensation from the organization and any related organizations during the year. (See Chapter 6.)

### (h) Parts VIII to XI (Financial Information)

Part VIII of the Form 990 is a revenue statement, Part IX is a statement of expenses (including functional reporting), Part X is a balance sheet, and Part XI concerns financial statements. (See Chapter 7.)

## § 1.6 LAW AND POLICY AS TO SUMMARY

As is discussed throughout (indeed, is the central message of this book), the new Form 990, while creating much new law, is also predicated on much preexisting law and policy. The Summary (Form 990, Part I) alone requires knowledge, to properly prepare it, of at least nine discrete bodies of law.

### (a) Mission Statements

The Summary requests a description of the filing organization's *mission* or *most significant activities* (line 1). Mission and activities are totally different concepts. An organization's mission is essentially equivalent to its *purpose* or *purposes*. Activities are the organization's undertakings engaged in to accomplish the mission or purpose. Thus, whether an activity is an exempt function is dependent on the context in which it is conducted. An activity can be an exempt program in one setting and a nonexempt function in another.

The federal tax law, which focuses on an organization's purpose or purposes, is silent as to the *mission statement* of a tax-exempt organization. (Or at least the law was until the advent of the new Form 990.) Most exempt organizations are creatures of state law; that body of law normally expects a nonprofit organization to have a *statement of purpose* (or purposes). A statement of purpose, however, tends to be a short, perhaps technical, rendition of what the objectives of an organization are. A mission statement, by contrast, can be lengthier and less technical in nature.

The IRS issued a draft of good governance principles for charitable organizations in early 2007. In the aftermath of adoption of the new Form 990, the IRS jettisoned that draft of governance principles, stating (on its Web site) that the current IRS positions on nonprofit governance "are best reflected in the reporting required by the revised Form 990." (That alone is ample evidence of the considerable significance of the new return.) Thus, in early 2008, the IRS replaced it with a new document as part of the agency's Life Cycle educational tool.

This new statement encourages charitable organizations (and to a lesser extent other tax-exempt organizations) to establish and regularly review the organization's mission. A clearly articulated mission statement, adopted by the organization's

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governing board, serves, the IRS has stated, to explain and popularize the charity's purpose and guide its work. It also addresses why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom.

**(b) Governing Instruments**

An organization must have governing instruments to qualify for tax exemption, if only to satisfy the appropriate organizational test. This is particularly the case for charitable organizations, as to which the federal tax law imposes specific organizational requirements (see § 1.6(c)). The document by which an organization is created is known generically, in the federal tax law, as the *articles of organization*.

If the corporate form is used, the governing instruments are articles of incorporation and bylaws. An unincorporated association will have articles of organization, most likely in the form of a constitution, and undoubtedly also bylaws. If the entity is a trust, the basic document is a declaration of trust or a trust agreement. A mission statement may be embedded in the articles of organization or may be in a separate document.

**(c) Organizational Test**

An organization, to be tax-exempt as a charitable entity, must be both organized and operated exclusively for one or more of the permissible exempt purposes. This requirement is reflected in an *organizational test* and an *operational test*. If an organization fails to meet either test, it cannot qualify for exemption as a charitable entity. (These tests are also available with respect to other types of exempt organizations but are not as well articulated in the law.)

An organization is organized exclusively for one or more tax-exempt, charitable purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower it to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

**(d) Statement of Purposes**

In meeting the organizational test, the charitable organization's purposes, as stated in its articles of organization, may be as broad as or more specific than the particular exempt purposes recognized in the law, such as charitable, educational, scientific, or religious ends. Articles of organization of charitable entities may not authorize the carrying on of nonexempt activities (unless they are insubstantial), even though the organization is, by the terms of its articles, created for a purpose that is no broader than the specified charitable purposes.

In no case will an organization be considered to be organized exclusively for one or more tax-exempt charitable purposes if, by the terms of its articles of organization, the purposes for which the organization is created are broader than the specified charitable purposes. The fact that the actual operations of the organization have been exclusively in furtherance of one or more exempt purposes is not sufficient to permit the organization to meet the organizational test.

An organization is not considered organized exclusively for one or more exempt charitable purposes if its articles of organization expressly authorize it to (1) devote

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more than an insubstantial part of its activities to attempting to influence legislation; (2) directly or indirectly participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office; or (3) have objectives and engage in activities that characterize it as an *action organization* (see Chapters 9–10). The organizational test, however, does not require that references be made in the organizational document to the prohibitions on private inurement, substantial private benefit, substantial lobbying, and political campaign activities.

A statement of purposes and a mission statement can be the same text in the same document. Or a mission statement can be a separate document. If the latter, the phraseology of the mission statement should not be inconsistent with the more formal statement of purposes.

### (e) Primary Purpose Rule

A basic concept of the law of tax-exempt organizations is the *primary purpose rule*. This rule is one of the fundamental bases for determination of the appropriate category of tax exemption (if any) for an organization. The principle is formally explicated in the law by the use of words such as *exclusively* and *substantially*. These words are generally subsumed, in this context, in the word *primary*. This principle of the federal tax law is generally applicable to all categories of exempt organizations.

The primary purpose of an organization is not taken into account only when determining whether it qualifies for tax-exempt status. This purpose can also be a critical factor in application of the unrelated business rules.

Development and review of a mission statement for a tax-exempt organization should be undertaken in a manner consistent with the requirements of the primary purpose test.

### (f) Independent Members of Governing Body

The federal tax law does not generally impose a requirement on a tax-exempt organization that some or all of the members of its governing body be *independent*. Special rules for hospitals, supporting organizations, and charities that are publicly supported by reason of the facts-and-circumstances test apply in relation to the composition of their governing boards. These rules, however, tend to focus more on whether board members are reflective of the community or whether board members who are not independent (i.e., are insiders, disqualified persons, or have a conflict of interest) control the organization. The IRS ruled that an organization with a board of two individuals could not qualify as a charitable entity because the board structure amounted to inherent private benefit.

Nonetheless, the filing organization must report the number of the voting members of its governing body that are *independent* (line 4).

### (g) Unrelated Business

The Summary requires that the filing organization report its gross unrelated business income and net unrelated business taxable income (line 7). The reporting of these amounts necessitates an understanding of the unrelated business rules. This body of law envisions a tax-exempt organization as a cluster of businesses, some of which are

## PART I—OVERVIEW OF NEW FORM 990

related to the organization's exempt purposes and some of which are unrelated to exempt purposes. A variety of exceptions is available for various activities and forms of income.

**(h) Program Service Revenue**

*Program service revenue* (line 9) pertains to forms of income that are generated by a tax-exempt organization as the result of the sale of services or goods. Contributions and grants (line 8) thus are treated separately. There may be an issue as to whether an item of revenue is derived from a *grant* or a *sale of services*. Synonyms for program service revenue are *exempt function income* and *related business income*.

**(i) Professional Fundraising Expenses**

The Summary must include a reporting of the organization's *professional fundraising expenses* (line 16a). There is no federal tax law definition of this term. It is, however, used at the state level where, in the administration of their *charitable solicitation acts*, the states define the term. Unfortunately, the states are inconsistent in the definition of the term *professional fundraiser*; some states employ the term to mean the same as *professional solicitor* and/or *professional fundraising consultant*, while others do not. (See Chapter 19.)

**§ 1.7 PREPARATION OF NEW FORM 990, PART I**

Organizations that are required to file Form 990 may describe their mission in Part I, line 1, and are required to describe their mission in Part III, line 1.

The Summary (Part I) poses 8 questions about an organization's activities and governance:

1. The organization is asked to briefly describe its mission or most significant activities (line 1). This is an unusual choice, because, as noted, the mission pertains to the organization's purposes, while activities, of course, mean actual operations. These are two different matters entirely. The filing organization gets to choose.
2. The organization must indicate (by checking a box) if it, during the filing year, discontinued its operations or disposed of more than 25 percent of its assets (line 2).
3. The number of voting members of the governing body (line 3) (see Form 990, Part VI, line 1a) (see § 5.2(a)(1)).
4. The number of independent voting members of the governing body (line 4) (see Form 990, Part VI, line 1b) (see § 5.2(a)(1)).
5. The total number of employees (line 5) (see Form 990, Part V, line 2a).
6. The total number of volunteers (if necessary, an estimate will suffice) (line 6).
7. The total amount of gross unrelated business revenue (line 7a) (see Form 990, Part VIII, line 12, column (C)) (see § 7.1(b)).
8. The net amount of unrelated business taxable income (line 7b) (see Form 990-T, line 34) (see § 7.1(b)).

### § 1.8 SUMMARY OF NEW FORM 990 SCHEDULES

The summary poses 10 questions about revenue, 5 of which concern the current year and 5 of which concern the prior year:

1. The amount of contributions and grants (line 8) (see Form 990, Part VIII, line 1h).
2. The amount of program service revenue (line 9) (see Form 990, Part VIII, line 2g).
3. The amount of investment income (line 10) (see Form 990, Part VIII, lines 3, 4, and 7d).
4. The amount of other revenue (line 11) (see Form 990, Part VIII, lines 5, 6d, 8c, 9c, and 10c of column (A), and 11e).
5. The amount of total revenue (line 12, which is the sum of the amounts on lines 8–11) (see Form 990, Part VIII, line 12, column (A)).

The summary poses 16 questions about expenses, 8 of which concern the current year and 8 of which concern the prior year:

1. The amount of grants and similar amounts paid (line 13) (see Form 990, Part IX, lines 1–3, column (A)).
2. The amount of benefits paid to or for members (line 14) (see Form 990, Part IX, line 4, column (A)).
3. The amount of salaries, other compensation, and employee benefits (line 15) (see Form 990, Part IX, lines 5–10, column (A)).
4. The amount of professional fundraising expenses (line 16a) (see Form 990, Part IX, line 11e, column (A)).
5. The total amount paid for fundraising, calculated on the basis of functional accounting (line 16b) (see Form 990, Part IX, line 25, column (D)).
6. The amount of other expenses (line 17) (see Form 990, Part IX, lines 11d, 11f–24f).
7. The amount of total expenses (line 18, which is the sum of the amounts on lines 13–17) (see Form 990, Part IX, line 25, column (A)).
8. The amount of revenue less expenses (line 19, which is the amount on line 12 minus the amount on line 18).

The summary poses 6 questions about net assets or fund balances, 3 of which concern the amounts at the beginning of the year and 3 of which concern the amounts at the end of the year:

1. The value of total assets (line 20) (see Form 990, Part X, line 16).
2. The amount of total liabilities (line 21) (see Form 990, Part X, line 26).
3. The value of net assets or the fund balance (line 22, which is the amount on line 20 minus the amount on line 21).

### § 1.8 SUMMARY OF NEW FORM 990 SCHEDULES

As noted, the new Form 990 includes 16 schedules.

**PART I—OVERVIEW OF NEW FORM 990****(a) Schedule A**

Schedule A of the Form 990 is used by charitable organizations to report their public charity status. Specific questions about supporting organizations include identification of the organization's type, a certification as to lack of control by disqualified persons, contributions from disqualified persons, and information about supported organizations.

There are separate public support schedules for the basic types of publicly supported charitable organizations. The public support computation period has been lengthened to five years, which makes it consistent with the advance ruling period public support test. An organization can claim public charity status on the basis of the facts-and-circumstances test on this schedule. (See Chapter 8.)

**(b) Schedule B**

Schedule B is the schedule used to report charitable contributions and grants. It is the same as the preexisting Schedule B.

**(c) Schedule C**

Schedule C comprises questions concerning political campaign and lobbying activities, principally by charitable organizations. Filing organizations are required to describe their direct and indirect political campaign activities, including the amounts of political expenditures and volunteer hours. There are separate parts for lobbying charitable organizations that are under the substantial part test and the expenditure test. Certain other types of tax-exempt entities must prepare additional parts of this schedule. (See Chapters 9 and 10.)

**(d) Schedule D**

Schedule D is used to report supplemental financial information, such as for investments, liabilities, conservation easements, donor-advised funds, art collections, trust accounts, and endowment funds. (See Chapter 11.)

**(e) Schedule E**

Schedule E is filed by organizations that constitute tax-exempt private schools. Most of this schedule relates to the requirement that the organization cannot, to be tax-exempt maintain a racially discriminatory policy. A question inquires as to whether the organization receives any financial aid or other assistance from a governmental agency. (See Chapter 12.)

**(f) Schedule F**

The essence of Schedule F is the reporting of activities outside the United States. These activities, such as program services, grantmaking, and fundraising, are reported on a per-region basis. Grant makers are required to describe their procedures for monitoring the use of grant funds. Information must be supplied if a grantee or other recipient of assistance is related to any person with an interest in the

## § 1.8 SUMMARY OF NEW FORM 990 SCHEDULES

grant-making organization. Additional details are required in instances of grants or other assistance to organizations or individuals. (See Chapter 13.)

### (g) Schedule G

Schedule G largely concerns fundraising activities. The filing organization indicates the type or types of fundraising in which it is engaged and provides information about any fundraising contracts (including those with insiders). The organization is required to list the jurisdictions in which it is authorized to solicit funds. A part of this schedule focuses on fundraising events; another part solicits details about gaming activities. (See Chapter 14.)

### (h) Schedule H

Schedule H is filed by tax-exempt hospitals. The first part of this schedule (Part I) is a “community benefit report.” The filing hospital indicates whether it provides free or discounted care to low-income individuals or those who are “medically indigent.” The hospital reports on its charity care (such as care at cost, unreimbursed Medicaid services, and other unreimbursed costs in connection with government programs) and other community benefits (such as health improvement services, health professions education, subsidized health services, and research). The organization is asked whether it prepares an annual community benefit report and to describe its charity care policy.

The second part of this schedule (Part II) inquires as to the hospital’s “community building” activities. These activities include physical improvements and housing, economic development, community support, environmental improvements, leadership development and training for community members, coalition building, community health improvement advocacy, and workforce development.

Another part (Part III) pertains to bad debt, Medicare, and collection practices. A fourth part asks questions about the use of management companies and involvement in joint ventures. A fifth part (Part V) seeks information about the hospital’s facilities. The schedule (Part VI) requests a description of how the organization assesses the health care needs of the communities it serves and how the organization informs patients about their eligibility for assistance under federal, state, or local government programs or under its charity care policy. (See Chapter 15.)

### (i) Schedule I

Schedule I is used to solicit information about the organization’s domestic grant and other assistance programs. For example, the organization is asked whether it maintains records to substantiate the amount of its assistance and about the organization’s selection criteria and grantees’ eligibility. Information is required for grants of more than \$5,000 to organizations and all grants to individuals. (See Chapter 16.)

### (j) Schedule J

Schedule J is used to solicit supplemental information about compensation. The organization must indicate (in Part I) if it provides to its insiders payments or items

**PART I—OVERVIEW OF NEW FORM 990**

in forms such as first-class or charter travel, a discretionary spending account, a housing allowance, or health or social club dues; it is asked whether it follows a written policy in connection with such payments (or reimbursements) or items. The organization is asked how it determines certain executive compensation and, in the case of charitable and social welfare organizations, whether it provided any form of nonfixed payments.

The organization reports information concerning compensation paid to trustees, directors, officers, key employees, and highly compensated employees (Part II). There is a breakdown as to base compensation, bonus and incentive compensation, deferred compensation, and nontaxable benefits. (See Chapter 6.)

**(k) Schedule K**

Schedule K is used to solicit information about tax-exempt bond issues (Part I) and the use of the proceeds (Part II). There are questions about the private use rules (Part III) and arbitrage (Part IV). (See Chapter 17.)

**(l) Schedule L**

Schedule L concerns excess benefit transactions and loans to and from interested persons. Information sought includes the name of the debtor/creditor, original principal amount, balance due, the purpose of the loan, and whether there is a written agreement. Questions are also asked about grants or other forms of assistance benefiting, and business transactions involving, interested persons. (See Chapter 18.)

**(m) Schedule M**

The focus of Schedule M is on noncash contributions. Thus, information is sought about gifts of art (including fractional interests), books, clothing and household goods, automobiles, airplanes, boats, intellectual property, securities, qualified conservation property, real estate, collectibles, food inventory, drugs and medical supplies, taxidermy, historical artifacts, scientific specimens, and archeological artifacts.

This schedule inquires as to the number of Forms 8283 received by the organization for contributions for which the organization completed the donee acknowledgment portion (see § 19.2(r)); whether the organization received any property that it must hold for at least three years from the date of its contribution, which is not required to be used for exempt purposes during the entire holding period; whether the organization has a gift acceptance policy that requires the review of nonstandard contributions; and whether the organization used third parties or related organizations to solicit, process, or sell noncash distributions. (See Chapter 19.)

**(n) Schedule N**

Schedule N pertains to liquidations, terminations, dissolutions, and significant dispositions of assets. Questions include a description of the assets involved, their value, the method of determining the value, the date of the distribution, and the name and address of the recipient. Other questions concern the involvement of an insider with the successor or transferee organization, notification of one or more state officials, and

## § 1.11 INSTRUCTIONS

other compliance with state laws. Additional information is sought concerning transfers of more than 25 percent of the organization's assets. (See Chapter 20.)

### (o) Schedule O

Filing organizations use Schedule O to provide additional information for responses to specific questions in the Form 990 and/or its schedules and to provide additional information.

### (p) Schedule R

Schedule R has as one of its purposes the identification of disregarded entities and related tax-exempt organizations. Related organizations taxable as a partnership and as a corporation or trust must also be identified. A series of questions about transactions with related organizations and unrelated organizations taxable as partnerships is posed. (See Chapter 21.)

## § 1.9 FORM 990-EZ

To alleviate the annual reporting burden for smaller tax-exempt organizations, the IRS promulgated a less extensive annual information return. This is the two-page Form 990-EZ. As noted, the Form 990-EZ for 2008 was released in late 2007.

Under current law, this return may be used by tax-exempt organizations that have gross receipts that are less than \$100,000 and total assets that are less than \$250,000 in value at the end of the reporting year.

## § 1.10 TRANSITION RULES

The IRS announced a graduated three-year transition period for annual information return filings. For the 2008 tax year (returns filed in 2009), organizations with gross receipts of more than \$1 million or total assets in excess of \$2.5 million are required to file the Form 990. For the 2009 tax year (returns filed in 2010), organizations with gross receipts over \$500,000 or total assets over \$1.25 million are required to file the Form 990. Tax-exempt organizations below these thresholds are allowed to file the Form 990-EZ (with the option to file the new Form 990).

The filing threshold will be permanently set, beginning with the 2010 tax year, at \$200,000 in gross receipts and \$500,000 in total assets. Starting with the 2010 tax year, the filing threshold for organizations required to file the Form 990-N (the e-postcard) (see § 1.11) will be increased to \$50,000 (from \$25,000).

## § 1.11 INSTRUCTIONS

The IRS, on April 7, 2008, issued draft instructions to accompany the new Form 990 for 2008. The IRS, on April 19, 2008, provided final instructions to accompany the Form 990 for 2008 (subject to approval of the Office of Management and Budget). These instructions provide guidance that is specific to each part and schedule of the new Form 990, plus an appendix of law and a 24-page glossary. The elements of these instructions are interspersed throughout this book.

## PART I—OVERVIEW OF NEW FORM 990

The instructions include a *sequencing list*, to assist an organization in completing the form and its schedules. As is noted, “certain later parts of the form must first be completed in order to complete earlier parts.” According to this list, here is the way to approach the new Form 990:

1. Complete lines A to F and H(a) to M in the heading of the return.
2. Determine the organization’s related organizations for which reporting will be required (see Schedule R).
3. Determine the organization’s officers, directors, trustees, key employees, and five highest compensated employees (to be listed in Part VII, Section A).
4. Complete Parts VIII, IX, and X (revenue and expense statements, and balance sheet).
5. Complete line G in the heading (gross receipts).
6. Complete Parts III, V, VII, and XI.
7. Complete Schedule L (concerning transactions with interested persons) (if required).
8. Complete Part VI. (Transactions reported in Schedule L are relevant to determining the independence of members of the governing body (Part VI, line 1b).)
9. Complete Part I (on the basis of information derived from other parts of the return).
10. Complete Part IV.
11. Complete remaining applicable schedules (for which “yes” boxes were checked in Part IV). (Schedule O is used to provide required supplemental information and other narrative explanation.)
12. Complete Part II (signature block).

Another unique feature of these instructions is the appendix, which provides information about:

- Types of tax-exempt organizations (a reference chart)
- Steps for determining various levels of gross receipts (such as the \$25,000 filing threshold)
- Public inspection of returns
- Group exemption returns
- Disregarded entities and joint ventures
- Excess benefit transactions

The Director of the Exempt Organization’s Division said: “We were immensely gratified by the amount and quality of public comments we received on the Form 990 redesign. Public input resulted in a form that meets the needs of tax-exempt organizations, the public and tax administrators.”