

Tax return Compliance Issues

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Background of reporting requirements:

Prior to 1942 there was no reporting by exempt organizations or the need to apply for exempt status. Starting in 1942 there was a 2 page reporting form which was enhanced but still used for the next 37 years.

In 1979 there was a major redesign of form 990. This was followed by form adjustments over the next 30 years.

In 2008 a complete overhaul of form 990 was completed, the first in 30 years. This new report is less of a statement of financial operations, as a report of the organizations governance practices.

The new reporting form is to report to the Internal Revenue Service that the organization is following sound policies and best business practices. Many of the questions refer to policies that are not required by the Internal Revenue Code, but reflect that the organization is well governed by the Board and would indicate that the organization is compliant with the requirements of the Tax Code.

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The new act also removed the 5 year probationary period for new exempt organizations.

The form 990EZ was not redesigned, though some changes were made. Still needed are Schedule A (support information to determine if the organization is not in compliance) and Schedule B (listing of donors who gave more than \$5,000 during the year)

You may not be required to file using the complete 990 this year, but the day is coming when you will be required.

Current reporting requirements:

- New 990N has been instituted to ensure that all exempt organizations have a minimal reporting requirement.
- If an organization does not file a return for 3 years in a row, the IRS will remove them from their list of exempt organizations. This is intended to clean up old organizations that are not in existence any longer. Last month the IRS announced that it eliminated over 227,000 exempt organizations from its files for lack of filing.

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Core form of new 990 is made up of 11 pages which apply to all organizations that are required to file the form. In addition, there are 16 schedules that may have to be filed. Questions on page 3 and 4 are designed to indicate which of the 16 schedules will need to be filed. Currently the IRS has indicated that new schedules are being contemplated.

Several questions are asked in different ways in different places, which can cause conflicts in reporting, so be wary of these traps.

Now a very public document:

The form will be read by your Board, supporters, future donors, Government funders, past and present employees, competitors, CPA's, attorneys, the media and the IRS.

It will continue to be available on guidestar.org and will be placed there sooner in the future. The new reporting requirements took these stakeholders into consideration and designed the new form to show transparency, compliance and accountability of your organization.

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Answering no to policy questions may not be detrimental to the organization, but it may not paint a favorable impression of the organization in the eyes of potential supporters or donors. The report is an opportunity for the organization to beat its own drum. For example, at the top of page one the organization is asked to briefly describe its mission and most significant activity. The organization can make a simple statement like “aid the homeless in our community”. Or it can say “provide innovative assistance to homeless families in our community by the involvement our volunteers and community and to assist the homeless to be better citizens and assist the global community”. In addition, on page two there is the opportunity to describe the organizations accomplishments during the last year. A simple reiteration of the mission statement would suffice, however, a self-serving statement of the accomplishments of the Board, staff and volunteers will put the organization in a more favorable light.

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Schedule O – Supplemental Information is where any indication of potential problems will show up. This schedule is required to report exceptions to rules or governance issues. The IRS and the public will look at this form closely. Therefore, the Board should closely scrutinize this Schedule before it is released.

Now an activities reporting document instead of a financial report:

In the past the 990 was a statement of financial activities. The new forms are designed to relate how well the organization is governed. The IRS will be looking for a clearly articulated purpose (mission statement), a knowledgeable and committed governing body and sound management practices. The tax laws do not mandate particular management structures, operating policies or administrative practices, but it is an indication that the organization is thoughtful about governance practices. Toward this end in Part VI on page 6 of form 990 there are questions about the governing body and its operations, written policies and compensation issues. None of these are required by the Internal Revenue Code, but the IRS will view these answers as possible management failures that

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will need scrutiny. Currently, none of these questions are required to be answered by organizations who file form 990EZ, but this will probably change in the next few years. (Refer to Accountability Checklist handout)

Compensation reporting is a big issue:

Part VII – must list all covered people, whether they had any compensation or not. Compensation is measured on the current or prior calendar year basis.

To protect the boards from sanctions, the IRS has established a three-prong safe harbor assumption that compensation is reasonable. Lack of reasonableness may expose the organization and/or its board to sanctions.

1 – The compensation must be approved by the board or compensation committee.

2 – Must use a method to establish compensation and indicate what that method is (independent consultant, Form 990 of other organizations, survey or study).

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3 – Must contemporaneously document the meetings held and actions taken.

The answers to the questions on Schedule J and Part VI are extremely important, as they will force the organization to admit whether it has a defense against sanctions, perhaps before it is even aware that it has provided a sanctionable excess benefit.

Other Issues:

The IRC requires an organization to make its Forms 1023 (original application for exemption), 990 and 990-T available to the public for inspection. The suggested format is on the organizations website or upon another organizations website (Guidestar.org), or upon request. (Schedule B – Schedule of Contributors is not public information so should not be disclosed to public)

The IRS requests (but is not required by the Code) that an organization also make available to the public it's governing documents (trust document, incorporation document), policy statements and financial statements.

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As of 1/1/05 the State of California requires charitable organizations with gross revenue of \$2,000,000 or more must have an independent audit and have an audit committee of its governing body.

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Raffles:

Governed by Penal Code section 320.5

The law allows raffles by non-profit organizations to raise funds for their exempt function.

The law requires that 90% of raffle gross proceeds be used for exempt purposes.

Organization must pre-register with the Attorney General's office before conducting raffle activity.

Organization must report to the Attorney General's office after the event is completed giving financial and operational details of event.

Registration period is for September 1 through August 31 of the next year.

Sales of raffles over the internet prohibited.

Results of registered events are available on line for view by the public.

Use form CT-NRP-1 to pre-register the event. Requires a \$20 filing fee.

Use form CT-NRP- 2 to report results of operation of event.

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RESOURCES

Board Policy Statements:

The instructions to Form 1023 provide a sample of a conflict-of-interest policy.

Two publications provide samples of conflict-of-interest, whistleblower and document retention policies:

- The Non-profit Policy Sampler, by Barbara Lawrence and Outi Flynn, published by BoardSource in 2006
- Managing Conflicts of Interest, by Daniel Kurtz and Sarah Paul, by BoardSource.

www.governancematters.org – good source for governance of your organization.

IRS website, FTB website and Attorney Generals website are also informative.

ACCOUNTABILITY CHECKLIST

Mission and Programs

- Our board reviews all programs and activities for alignment with the organizational mission.
- We comply with best practices in our field of service.
- We establish performance goals for each program and activity.
- We evaluate each program and document the results.
- We meet the requirements specified in grant agreements.

Impartiality and Ethics

- We have a code of ethics.
- We have a conflict of interest policy.
- We have an executive compensation policy.
- We have a nondiscrimination policy.
- We have a whistleblower policy.
- We have a confidentiality policy.
- Our board is comprised of independent directors.
- Every board and staff member has a copy of the current bylaws.

Legal Compliance

- We are in compliance with our bylaws.
 - Selection of directors
 - Terms of directors
 - Term limits
 - Duties of directors
 - Election of officers
 - Duties of officers
 - Quorums and other requirements for decision-making
 - Number of meetings
 - Proper notice of meetings
- Our board verifies that the information submitted on IRS Form 990 and any accompanying forms is accurate.
- The IRS Form 990 is filed annually and on time.
- Our registration with the California Secretary of State is renewed within four and one-half months of the close of our fiscal year.
- Our Annual Business Report is filed with the California Secretary of State in the month of the anniversary of our incorporation.
- We have obtained and retain documentation of state and local exemption from sales and property taxes.

Legal Compliance (continued)

- Employment-related tax payments and reports are regularly filed with the California Department of Revenue and with the IRS.
- IRS Forms I-9 and W-4 are completed for each employee.
- IRS Forms W-2 and 1009 are provided to each employee and contractor, respectively, by Jan. 31 every year.
- Notices required by the California Department of Labor and Employment, EEOC, OSHA and US Department of Labor are posted.
- We comply with Title VII and the Americans With Disabilities Act.
- We understand and obey all IRS regulations related to lobbying.
- We do not engage in political campaign activities.

Resource Development, Allocation and Management

- We have adopted the AFP's Donor Bill of Rights.
- We meet the IRS requirements for substantiation and reporting of our donors' contributions.
- We are registered with the California Secretary of State as an organization that solicits charitable contributions.
- When we conduct a raffle or bingo game, we have obtained a license from the California Secretary of State and attended a Games Manager training.
- Our budget contains clearly defined line items.
- Funds solicited for specific purposes are segregated in restricted line items and are released for use only for that specific purpose.
- We have adequate general liability insurance.
- We maintain appropriate property and automobile insurance.
- We have directors and officers liability insurance.
- We have internal financial control policies.
 - Authorized check signers
 - Petty cash
 - Substantiation of expenses
 - Travel & other expense reimbursement policies
- We have a document retention policy.
- We have fire- and water-safe storage for important documents and records.

Transparency

- Our Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code - Form 1023 is easily accessed by the public.
- We keep the last three years' IRS Form 990 accessible to the public.
- Minutes of board meetings, evaluation reports and financial reports are open to the public.
- The board of directors has a documented procedure for receiving public input about our organization and its programs.
- We publish an annual report that:
 - Explains our mission
 - Demonstrates how each program supports our mission
 - Communicates the impact and results of each program
 - Highlights our accomplishments
 - Lists board and staff members
 - Acknowledges partnering agencies and lists organizations with which we collaborate
 - Provides a clear and accurate picture of our financial health:
 - Income and expense
 - Balance sheet
 - Functional expense allocation

Congratulations! If every item on this list is checked off, you can celebrate your organization's high AQ! You are demonstrating accountability.