



Nonprofit Notes

A Digest of Developments Affecting the Nonprofit Community

Winter 2008, Vol. 1.1

Inaugural Edition

Welcome. You are holding the inaugural issue of Tucker Ellis & West's Nonprofit Notes. This newsletter will provide busy stakeholders of nonprofit organizations with current and concise information about industry, legal and tax developments affecting the nonprofit community. The articles are brief so you can read them quickly and gather the essential information you need to stay current about issues that matter to you. From time to time we'll include a "Two Minute Compliance Check" that helps you make sure your organization is in step with some of the key rules affecting your nonprofit organization.

Thank you for your interest in this publication. We welcome your comments concerning the newsletter. We are also happy to add anyone you might like to our regular mailing list.

- Bernie Smith, Nonprofit Group Chair



THIS ISSUE

New Form 990 Issued

Issued in December 2007, one IRS official has described the new form as the "biggest thing the exempt organizations division has done in the last quarter century."

OH Attorney General Rules for Charities May Appear

Ohio Attorney General Mark Dann has taken the first step in the development of proposed regulations affecting a wide variety of hospital operations.

2 Minute Compliance Check

A quick check to test how your exempt organization stacks up under the prohibition on political campaign activity.

IRS Plans for 2008

A summary of the IRS' "to do" list for the coming year.

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IRS Issues Revised Form 990

In late December 2007, the IRS issued the final draft of its long awaited revised Form 990. The release was described by one IRS official as the "biggest thing the exempt organizations division at the IRS has done in the last quarter century."

Form 990 is the tax filing required annually of most exempt organizations. For years, the form has consisted of a "core" form of nine or so pages and two schedules. The revised form includes a core form of 11 pages and up to 16 schedules. The majority of exempt organizations will be required to file only a handful of these schedules.

The IRS emphasized three objectives in revising the 990: increasing compliance, promoting transparency and minimizing the burden of exempt organizations. Many of the Form 990 revisions trace their origins to the influence of Sarbanes-Oxley, nonprofit reform proposals of various trade groups, IRS initiatives and Congressional oversight of the nonprofit sector. For example, in March, 2005, the Independent Sector issued its recommendations for nonprofit reforms. High on its list of suggestions was increased transparency and better reporting by exempt organizations.

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Hospitals Take Heed

Ohio Attorney General Invites Participation in Developing New Rules

Earlier this week, Ohio Attorney General Marc Dann announced plans to review a number of business practices at Ohio's nonprofit hospitals. This is likely to be the first step in the development of proposed regulations affecting a wide variety of hospital operations. The review and any resulting rules will deal with a broad range of topics such as executive compensation, the amount of charity care provided and how it is measured and disclosed, collection efforts with respect to unpaid medical bills and services to indigent patients.

In mid-2006 then Attorney General Jim Petro, without advance notice, published proposed rules on many of the above topics. Those rules were met with significant objection from the nonprofit hospital community. While Attorney General Dann's efforts will touch on many of the areas addressed in Petro's proposed rules, the Attorney General has promised a collaborative approach, involving hospitals in the process from the outset.

The announcement by Attorney General Dann is a significant development for all nonprofit hospitals. Coupled with the IRS efforts at revising the Form 990 and potential Congressional action implementing reforms proposed by the Senate Finance Committee, nonprofit hospitals must remain ever attentive to how they deliver, track and report the community benefits they provide.

The invitation by Attorney General Dann to collaborate in the process of reviewing nonprofit hospitals should be considered seriously by all affected organizations. We urge you to weigh the value of participation in this endeavor.

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IRS Issues Revised Form 990 (continued)

Significant features of the revised “core” form of the 990 are: a summary of activities and key financial information (Part 1); a checklist of required schedules (Part IV); an inventory of other IRS filings and questions about tax compliance (Part V); detailed questions about the organization’s governance and management (Part VI); and more detailed inquiries concerning compensation of key personnel.

The revised 990 is the “biggest thing the exempt organizations division at the IRS has done in the last quarter century.”

Some of the questions in the revised Form 990 seem to indicate an attempt by the IRS to elevate certain standards it believes should apply to exempt organizations to actual legal requirements. For example, questions concerning the composition of the governing board and whether the organization has a conflict of interest policy reflect standards the IRS believes should apply to all 501(c)(3) organizations even though there are no corresponding requirements in the Internal Revenue Code.

The multitude of schedules included in the revised 990 are largely the result of the IRS using separate schedules to obtain further information about a number of areas addressed in briefer form on the current 990. However, some schedules explore areas not scrutinized under the existing form. These include foreign activities, hospitals, tax-exempt bond issues and non-cash contributions.

New Schedules A, B & D for Almost All

Few, if any, organizations will be required to file all or even a majority of the schedules included in the new 990. Most exempt entities will file Schedule A, concerning public charity status, Schedule B, concerning contributors, and Schedule D, which is designed to pull together in one place all supplemental schedules required by the revenue and expense statements and the balance sheet of the core form.

Schedule C for Political Activities

Organizations that engage in lobbying or political activities will be required to complete a new Schedule C concerning that conduct. This is an area of special concern for 501(c)(3) organizations because they may engage in only limited lobbying activities and may not engage in any political activities in support of or in op-

position to a candidate for elective office.

Schedule J for Higher Compensation

Organizations with high dollar or complex compensation arrangements must complete a new Schedule J. This schedule is one of the more interesting and potentially problematic documents in the revised Form 990. It is intended to provide more detailed reporting and information concerning individuals whose compensation exceeds certain thresholds, including any recipient of W-2 compensation of more than \$150,000 or total compensation (that is wages and all benefits) of more than \$250,000. Part 1 of this schedule includes a number of new questions including inquiries about fringe benefits such as first class travel, travel for companions, tax indemnifications and gross-ups, club dues and personal services. This schedule also includes questions about whether the organization has a compensation committee, uses independent compensation consultants or compensation surveys and whether there are written employment contracts in place. The form also includes questions on severance payments, contingency payments and non-fixed payments.

New Schedule H for Hospitals

Hospitals will find themselves obligated to file a new Schedule H which is principally concerned with charity care, treatment of bad debts and community benefits. Many of the questions on this schedule harken to themes sounded in a hearing conducted by then Senate Finance Committee Chairman Grassley concerning the level and manner of determining community benefits provided by tax-exempt hospitals. All tax-exempt hospitals should take steps now to track and review reporting practices concerning the variety of community benefits they provide.

More Organizations Will be Required to File More Reports

Smaller nonprofits will likely disagree with the IRS’s view that the new 990 minimizes tax reporting burdens. That is because eventually more organizations will be required to file a regular Form 990 rather than a 990-EZ. Under current rules, organizations with receipts less than 1 million dollars and assets less than 2.5 million dollars may use Form 990-EZ. New rules phased in from 2008 to 2010 will result in those thresholds being lowered until eventually only organizations with both less than \$200,000 of gross receipts and less than \$500,000 in assets may use the 990-EZ.

2 Minute Compliance Check for 501(c)(3)s

Here's a quick check to test how your organization stacks up under one of the critical rules governing 501(c)(3) organizations -- the prohibition on political campaign activity.

Background

501(c)(3) organizations may not engage in political campaign activity of any type. Political campaign activity generally consists of actions in support of or in opposition to a candidate for elective office. Violation of this rule can result in the imposition of significant penalty taxes and/or the loss of tax-exempt status. A different restriction applies to lobbying activities of 501(c)(3) organizations. The two rules should not be confused – political campaign activities are absolutely prohibited; lobbying activities, on the other hand, are not forbidden but only subject to certain restrictions. Different rules apply to other categories of exempt organizations, such as trade associations and business leagues.

May your CEO lend her name to a political campaign ad?

The Quiz

Review each of the questions below and ask yourself whether the conduct described violates the rule against exempt organizations participating in political campaign activities. Do your answers agree with those of the IRS?

1. Your CEO allows his or her name and title to be listed in a newspaper ad in support of a candidate. The ad identifies your CEO by name and position with your organization. The ad states that titles and affiliations are provided for identification purposes only. The ad is paid for by the candidate's campaign organization.
2. Your organization publishes a monthly newsletter. Each issue of the newsletter includes a column by the president of your organization. In a column that appears prior to an election, the president states: "It is my personal opinion that Candidate X should be re-elected." While your organization usually bears the entire cost of its newsletter, for this issue the president pays the amount of costs attributable to the president's column.

3. Your CEO is well known in the community. Three weeks before the election, the CEO attends a press conference at a candidate's campaign headquarters and states that the candidate should be re-elected. The CEO does not say she is speaking on behalf of your organization. However, her endorsement is reported on the front page of the local newspaper and she is identified in the article as your CEO.
4. Your organization educates the public on conservation issues. During a regular meeting of your Board of Directors held shortly before an election, the chair of your volunteer board speaks on a number of issues, including the importance of voting in the upcoming election. He concludes by stating, "It is important that you all do your duty in the election and vote for Candidate W."

The Answers

Situations (1) and (3) above do not describe a violation of the ban on political campaign activities. In the first example, there is no violation because the organization did not use its funds for the ad, the ad was not a publication of the organization and the CEO acted in his or her personal capacity. The third scenario does not present a problem because the event did not take place at the organization's offices or require use of the organization's assets and the CEO did not indicate she was speaking on behalf of the organization.

Situations (2) and (4) describe violations of the political campaign prohibition. In example (2), the rule is violated because the president's endorsement appeared in an official publication of the organization; that the president personally paid the costs of the column is irrelevant. The actions in the fourth hypothetical are problematic because they indicate support for a particular candidate and took place during an official meeting of the organization.

Rule and Authority

The general rule that runs through the above hypotheticals is that if an individual associated with a 501(c)(3) organization is acting clearly in his or her individual capacity and not using an organization's assets or resources, the activity will generally not violate the rule against political campaign activity. For more details on the above examples and the description of other situations concerning political campaign activity, please refer to Rev. Rul. 2007-41, 2007-25 I.R.B.

IRS Work Plan for 2008

The IRS Exempt Organizations Division issues annually a “work plan” for the following year. This document provides an excellent preview of areas where the IRS will focus its future audit and enforcement activities. The recently issued work plan for FY 2008 indicates the IRS will continue its examination of the compensation practices and political activities of exempt organizations. In addition, universities and colleges can expect increased scrutiny from the IRS National Office, probably in the form of compliance questionnaires similar to those used in the hospital sector in past years.

The IRS will continue to shine a spotlight on the compensation arrangements of tax-exempt organizations.

Executive Compensation

In light of reports on the high salaries and generous benefits afforded to executives at some charities and foundations, the IRS undertook an Executive Compensation Compliance Project to review the compensation practices of a broad spectrum of exempt organizations. On March 1, 2007, the IRS released a report on progress in the first two phases of the project. For 2008 the IRS plans to continue the Executive Compensation Compliance Project by: conducting 200 compliance checks and 50 single issue examinations focusing on organizations with loans to officers, directors and trustees; continue executive compensation examinations initiated in its Hospital Compliance Project; conduct over 90 limited scope field examinations regarding the compensation practices of small and mid-size 501(c)(3) organizations; and review executive

compensation paid by colleges and universities.

Political Activities

The IRS will continue to investigate allegations of political campaign intervention by section 501(c)(3) organizations, including direct contributions to candidates. The IRS will also expand its prior reviews of political campaign activities to look at public charities that make a contribution to political action committees (PACs). Other proposed activities include reviews of private foundations that contributed to a candidate for public office or a PAC or made a payment to a ballot initiative committee, and follow-up on previously contacted or examined organizations to ensure that they are not involved in prohibited campaign activities.

Colleges & Universities

In 2008, the IRS will conduct a research/compliance initiative involving colleges and universities. It plans to gather information from a sampling of colleges and universities to gain a better understanding of how they:

- report income and expenses on Form 990;
- calculate and report losses on Form 990-T;
- allocate income and expenses in calculating their unrelated business taxable income;
- invest and use their endowments; and
- determine executive compensation.

The project will involve a compliance check questionnaire sent to a cross-section of small, medium and large colleges and universities and focused examinations of some respondents.

TEW NONPROFIT PRACTICE GROUP

Tucker Ellis & West attorneys serve as professional advisors to a broad array of tax-exempt organizations. Our attorneys routinely assist nonprofit organizations with their qualification and maintenance of tax-exempt status, business counseling, compensation and benefits, planned giving programs, board education and training, representation before the Internal Revenue Service, preparation and updating of government instruments, tax and reporting issues and family philanthropy issues. Our aim is to enable exempt organizations to deal effectively and efficiently with regulatory issues while preserving the organization’s limited resources for mission accomplishment.

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