

# Form 990 Thoughts for a New Year

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As the nonprofit industry continues to grow and change, so must their annual reporting to the governmental entity that grants them the right to be tax exempt, the Internal Revenue Service (“IRS”). Since the IRS’s recent overhaul of the Form 990 in 2008, many tax exempt entities have been trying to determine the information required to be reported and to make updates to their accounting system in order to capture the required information.

Since 2008, the actual Form 990 has changed very little as the IRS has focused on clarifying issues by updating the instructions. Each year, the IRS has added examples and clarifying language to the instructions with the intention of reducing areas of ambiguity. Additionally, the American Institute of Certified Public Accountants (“AICPA”) has acted as an additional resource to help exempt organizations understand the information required. Each year the AICPA has provided a list of topics of particular concern to the industry and their recommendations on how to ensure compliance with the IRS’s instructions. Below, we discuss some of these topics brought forth at a recent AICPA seminar along with their proposals for maintaining compliance with the IRS.

### **Related Party Transactions**

The fact that governance continues to be the top focus for the IRS leads the AICPA panel to once again underscore the importance of a particular information-gathering tool; the Board Survey. In determining the existence or extent of related party transactions and assessing Board member independence, the IRS requires the organization to make a “reasonable effort” to obtain information about its Board members. A simple, brief questionnaire given to Board members goes a long way in establishing the “reasonable effort” criteria.

### **Who Should Sign the Return?**

Particularly for smaller organizations, the question of who may sign the return may become an issue when filing season rolls around. The general rule is that any “authorized officer” may sign the return and the instructions to the Form 990 spell out the president, vice president, treasurer, assistant treasurer, secretary, and chief accounting officer as being *per se* authorized to sign the return. However, the Board may authorize any individual to sign the return. That individual then becomes a *de facto* officer for the organization for the period specified for return filing purposes.

### **Donation of Airfare**

An interesting issue that arises is what to do when an organization receives a donation of airfare. The question becomes whether to treat this donation as a non-cash donation of goods, which would have it included as revenue on Form 990 or to treat it as a contribution of services, which is reconciled out of Form 990 completely. The treatment of donated airfare hinges on the identity of the donor. If an airline donates vouchers for free airfare; that would generally be considered a donation of services and would be excluded from the Form 990. On the other hand, when an individual purchases airline tickets and donates them to the organization, the tickets would be considered a non-cash contribution, reported on the Form 990. The major caveat is when the organization holds the airfare not for its own use, but for resale, such as at a fundraising event. In this case, the airfare is treated as a non-cash contribution regardless of the contributor and the revenue generated is reported on Schedule G of the Form 990.

### **Unrelated Business Income**

Organizations are subject to tax on their unrelated business activities. Unrelated business income (“UBI”) includes income from an activity which is (a) a trade or business, (b) unrelated the organization’s exempt purpose, and (c) regularly carried on. A key aspect of the classification as a trade or business is profit motive. For example, an activity is not a trade or business if it is not being engaged in for profit. This is particularly important if the activity is generating losses which the organization hopes to use to offset other sources of UBI. The IRS can be expected to assert that an activity with a history of losses is not being engaged in for profit; however, it is certainly worth noting that the absence of profit does not necessarily imply the absence of profit motive.

Accelerated depreciation, favorable tax treatment, and adverse economic conditions can all serve to depict a profit-driven activity as being not a genuine trade or business. For example, courts may test whether the exempt organization is a trade or business by considering its profit motive, whether the activity is competitive with for-profit endeavors, or whether the activity has the characteristics of a business as defined in other areas of the tax law. It is important that the organization carefully assess its potential and actual unrelated business activities to ensure that they are treated appropriately.

### **Independent Contractors**

The Form 990 requires the organization to disclose its five highest compensated independent contractors who received more than \$100,000 in compensation during the year. For this purpose, an independent contractor includes any entity that provides services to the organization. An important distinction here is to differentiate between payments for services and reimbursement for expenses. Only the portion relating to payment for services needs to be considered in determining whether an independent contractor is one of the five highest compensated. However, if the organization is unable to separate fees from reimbursements, the entire amount of payment must be included on Form 990.

### **Extensions**

A constant source of puzzlement in the non-profit sector is the pair of three-month extensions (one automatic and one additional) for the Form 990 while every other Form generally enjoys a single five or six-month extension. The IRS has recently responded to the constant stream of inquiries into this anomaly by stating that it does not believe it has the authority to change the two-extension regimen. Both the IRS and AICPA have taken the position that a change in the extension procedure would require a congressional act, signaling no change in the near future.

As additional changes and updates to the Form 990 and underlying regulations are made, Johnson Lambert & Co. LLP will continue to issue alerts about possible opportunities to increase the efficiency of both gathering the required information and filing the necessary forms with the IRS to ensure compliance. We look forward to serving your needs each year and taking a pro-active approach to inform you of the changing trends in the nonprofit industry.

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