EXEMPT PERSPECTIVE

Has the IRS Met Its Goals with the New Form 990?

by Lisa A. Stegink

More than a year ago, tax-exempt organizations and their advisors started preparing for the new Form 990 – the IRS's long overdue re-design of the annual information reporting form filed by tax-exempt organizations. The new 11-page "core" section for all tax-exempt organizations and 16 potential schedules incorporate major changes and significant additions. Organizations that have not yet been required to file the new Form 990 are holding their collective breath to see how the experience goes for the first round of filers.

The IRS articulated essentially three main goals with the overhaul of the Form 990: promoting tax compliance; enhancing transparency to provide the IRS and the public with a realistic picture of the organization; and minimizing the administrative burden on filing organizations. Organizations that have spent any time with the new Form 990 may wonder whether they are looking at the same form as the IRS, particularly when it comes to minimizing the burden on filing organizations.

"Invasive," "traps for the unwary," "data mining," and "does little to increase compliance" are phrases that have been variously used by exempt organizations' financial staff, chief staff officers, and attorneys to describe the newly revised Form 990. This article considers whether the IRS really is meeting its goals, based on input from individuals responsible for completing, reviewing, and advising various size organizations on how to complete the Form 990.

Goal 1: Increase Tax Compliance

Can the IRS really change behavior as aggressively as it seems to be trying to do? One CFO of a large national professional society does not think so. According to him, the IRS appears to be trying to close loopholes for a small percentage of groups and all the rest have to pay: "Rather than audit the two percent of organizations that need it, the IRS is asking all the audit questions and making every organization send it in."

In other words, this CFO believes the level and type of questions asked are more appropriate as part of an audit than as standard tax information reporting. Moreover, organizations that are not compliant now are not likely to answer the questions any differently or be more likely to comply simply because there are more, or more detailed, questions. Another CFO agrees that while the new form may make the organization more "transparent" by putting more information out to the public, it does little to increase tax compliance.

In addition to required reporting on finances and activities, many sections address relationships within the organization and policies and practices helpful to ensure good governance. When asked why it included questions on governance, the IRS conceded that many of the questions request information on practices or policies that are not required by the federal tax law. Nevertheless, it believes that good governance and accountability practices provide safeguards that the organization's assets will be used consistently with its exempt purposes. The Form 990's Checklist of Required Schedules also is intended by the IRS to provide "a quick view of whether the filing organization is conducting activities that raise tax compliance concerns, such as lobbying or political campaign activities, transactions with interested persons, and major dispositions of assets."

Despite these goals, the questions may create confusion and make it more difficult than before for organizations to comply. It is true that some obscure statutory references on the Form 990 were replaced with specific, directed questions. However, it is essential for each organization and its tax preparer to review the definitions

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and instructions carefully to unearth the real questions. In some cases, questions that appear clear on their face must be answered differently than a straightforward reading of the question would imply. Organizations may unintentionally over-disclose or simply answer questions incorrectly if they are not careful.

In other cases, the same information is required in multiple places (e.g., independent contractor compensation, deferred compensation), or the organization must report information differently on the form than it does in practice. For example, some schedules require salaries and payments to vendors to be reported on a calendar year basis, even if the organization's financial reports are completed on a fiscal year basis. All those factors increase the likelihood that organizations will make inadvertent reporting and compliance mistakes.

Goal 2: Enhance Transparency

The IRS believes that "well-governed and well-managed organizations are more likely to be transparent organizations with regard to their operations, finances, fundraising practices, and use of assets for exempt and unrelated purposes." Opinions differ on whether the IRS, donors, members, and others interested in an organization will get a "realistic" and more transparent picture of any organization, or whether more confusion will result from the re-designed Form 990.

Some believe the new form will help unsophisticated readers understand an organization's activities and financial position. Others find transparency is not improved. A CFO from an international trade association said, "With all of the requirements, any layman trying to get a feel for the organization will in all likelihood be very confused or give up!"

Many organizations already are "transparent" in their reporting. For example, Code Sec. 501(c)(3) organizations have been required to disclose information, such as key employee compensation, and to take steps to avoid excess benefit transactions for some time, so the changes do not enhance transparency for them.

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Yet, much has changed in the new form. Schedule O is a new schedule for providing further detail on questions answered, and for voluntary disclosure of anything not covered elsewhere. A tension can arise between fully describing the organization and its most important activities, and saying too much. The IRS generally encourages adding descriptions on schedules to supplement answers on the form. Organizations often desire to use the Form 990 as a public relations piece and a way to showcase the organization in a nutshell. However, they must remember that Form 990 is signed under penalty of perjury and the organization will be held accountable for all statements made. From a legal perspective, organizations must answer truthfully and fully, but also should suppress the urge to say everything that could possibly be said about the organization.

One CFO noted a potentially unintended result of "enhanced transparency." Because names and salaries of the five highest compensated employees paid more than $100,000 must now be disclosed publicly, tensions among employees could increase. Describing the question as "invasive," this CFO believes such salary disclosures could force employee salaries up or down from existing levels for no reason other than the required IRS disclosure. Organizations might reduce salaries to avoid disclosure, or raise salaries in response to perceived inequity among employees at a particular job level.

Goal 3: Minimize Administrative Burden

The consensus is clear that the IRS not only failed to minimize the administrative burden on reporting organizations, but it increased the burden substantially. The CFO of a large national trade association said, "Let me put it this way. Not in all my years have I had to consult an attorney in order to complete the Form 990–until now." The IRS re-organized the layout of the form in an apparent effort to make it easier for someone who is not an accounting or legal professional to understand what is reported. However, organizations completing the form are having more difficulty and needing much more time to figure out how to report accurately.

Another CFO was very concerned that the association's

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valuable resources—including member dues and volunteer time—must be spent on additional consulting and legal fees, and board review necessary to complete the Form 990. "Not only do these efforts draw us away from the organization's mission, but obtaining governing body review may take weeks of time in our case, and cause significant levels of frustration among board members."

Moreover, for many organizations, such as Code Sec. 501(c)(6) trade and professional organizations, the reporting requirements go beyond what the law requires for tax compliance. For example, Code Sec. 4958 imposes intermediate sanctions for excess benefits transactions on 501(c)(3) and 501(c)(4) organizations. Yet, all organizations now are required to answer questions regarding how they determine compensation, and whether their process for compensation decisions includes review and approval by independent persons, comparability data, and contemporaneous substantiation of decisions. Those are the three elements of a "safe harbor" for 501(c)(3) and 501(c)(4) organizations, but are not required by law for other types of exempt organizations.

In the current economic climate, the timing is bad for expending additional resources, particularly to answer operational questions that are not required by law or, some would argue, not appropriate for the IRS to ask. Many small organizations, in particular, could potentially be more at risk for answering incorrectly, especially if they need outside review but do not seek it for resource reasons.

Private Foundations and Form 990-PF

How the changes in Form 990 will flow through to private foundations is currently unknown. Although speculation is that agents may start applying similar principles to private foundations, the IRS recently indicated it anticipates no changes to the Form 990-PF in the near future. In any event, private foundations, for which the rules are more restrictive than for public charities, should consider themselves "on notice" of potential changes.

By providing feedback, the collective experiences and learning of numerous organizations could potentially contribute to improvements in the form and to the IRS's approach to tax-exempt organization information reporting.

Final Thoughts and Recommendations

To many, the re-designed Form 990 does not meet the IRS's goals to increase compliance and transparency and minimize the administrative filing burden. Improvements to the Form 990 are needed to meet those goals. One approach the IRS could take is to apply the "80/20 rule." Under the 80/20 rule, the IRS could obtain 80 percent of the information it needs and achieve 80 percent of its goals with only 20 percent of the questions it asks on the Form 990. For example, by focusing on the top five problem situations from the IRS perspective, such as business transactions with interested persons, the IRS could craft detailed, audit-like questions that would give the IRS the critical information it needs to address major concerns.

Organizations that have not yet filed should continue to learn as much as they can about the new form and ask questions of their legal and tax advisors. They should ensure that governance policies are in place, and they should answer questions and describe activities with care and attention. If possible, they should do a "dry run" well in advance of the tax deadline to give the organization and its leadership time to work through the form and ask additional questions of attorneys and accountants. By identifying potential issues now, there is time to take thoughtful action, as necessary or appropriate, to minimize scrutiny and avoid leaving misimpressions with the IRS, members, donors, or the public.

If an organization already has filed the new Form 990, now is the time to provide feedback to the IRS. The IRS has specifically asked for comments on the re-designed Form 990 and the experience of filers with the new form. By providing feedback, the collective experiences and learning of numerous organizations could potentially contribute to improvements in the form and to the IRS's approach to tax-exempt organization information reporting. ●