[buck research]

fyi® for your information®

Volume 31 | Issue 63 | October 6, 2008

Final Form 990 for Tax-Exempt Organizations Requires Extensive Reporting of Executive Compensation

On August 19, 2008, the IRS issued final instructions for the redesigned Form 990 to be used for the 2008 tax year.

Background

In late 2007, the IRS released a new Form 990 for tax-exempt organizations, representing the first change in the form since 1979. The new Form 990, which is to be used in 2009 for the 2008 tax year, contains a Core Form to be completed by all filers and 16 schedules to be completed depending on the organization's type and activity. After seeking public comment, the IRS issued final instructions for the 2008 Form 990 on August 19, 2008.

The major changes to the Form 990 include a new summary page, a new governance section, increased details on executive compensation and the organization's relationships with insiders and other organizations, along with new reporting for hospitals, tax-exempt bonds, noncash contributions, and foreign activities. This *For Your Information* will focus on the executive compensation reporting requirements.

Executive Compensation Reporting Requirements

The new Form 990 contains three sections with questions relating to executive compensation – Parts VI and VII of the Core Form and a new Schedule J. All organizations are required to complete the Core Form, but only certain organizations will need to file Schedule J.

Reporting Requirements for Part VI

Part VI is a new section relating to governance, policies and disclosures. With respect to executive compensation, Question 15 in this section asks whether the process for determining compensation included a review and approval by independent persons, comparability data and contemporaneous substantiation of the process for the following individuals – the CEO, the Executive Director, top management, other officers or key employees.

If the organization answered yes to this question, it must describe the following on Schedule O (Supplemental Information to Form 990) –

buckconsultants an ACS company

- the process
- the offices or positions for which the process was used to establish compensation
- the year in which this process was last undertaken for each such person.

> ***BUCK COMMENT.*** *As noted above, the instructions state that an explanation needs to be provided on Schedule O if the organization answered yes to this question. However, regardless of the answer, an organization may wish to describe the process for determining compensation for these individuals to show good governance to both the IRS and other interested parties.*

Reporting Requirements for Part VII

Individuals to be Reported

The table in Part VII requires a listing of the name, title, and position of –

- all current officers, directors, and trustees, regardless of amount of compensation
- current key employees who earned more than $150,000
- the five current highest compensated employees (other than officers, directors, trustees or key employees) who received reportable income of more than $100,000
- all former officers, key employees or highest compensated employees who received more than $100,000 of reportable income
- all former directors or employees who received more than $10,000 of reportable compensation.

Organizations are also required to list the names of independent contractors who received more than $100,000.

> ***BUCK COMMENT.*** *Compensation is determined and reported on a calendar year basis. For fiscal year filers, the organization must use the calendar year ending in the fiscal year. Since the amounts paid for calendar year 2008 will need to be reported in the forms filed next year, it is recommended that employers begin now to assemble the information.*

Officers. The new instructions explain that officers are defined to include individuals elected or appointed to manage the organization's daily operations. The instructions also provide that officers of an organization are determined by reference to the entity's organizing documents, bylaws, resolutions of its governing body, or as otherwise consistent with state law. At a minimum, the organization must include in Part VII officers required by state law and the "Top Management Official" and the "Top Financial Official," regardless of their actual titles. The instructions define the top management official as the person who has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization. The top financial person is the person who has the ultimate responsibility for managing the organization's finances.

Key Employees. The new instructions also expand the definition of key employee to include employees other than officers, directors or trustees who meet all of the following requirements –

- had reportable compensation exceeding $150,000 for the calendar year
- had responsibilities, powers or influence over the organization as a whole, managed a discrete segment or activity that represents 10% or more of the activities, assets, income or expenses of the organization, or had authority or shared authority to control 10% or more of the organization's capital expenditures, operating budget, or compensation of employees
- was one of the 20 employees with the highest reportable compensation from the organization and related organizations.

Information to be Reported

For each individual listed, the following must be reported –

- average hours worked
- reportable compensation from the organization
- reportable compensation from related organizations
- estimated amount of other compensation from the organization or related organizations.

The requirements to disclose hours worked and reportable compensation have not changed substantially from the previous Form 990. However, with respect to compensation paid by a related organization, the reporting organization is required to use reasonable efforts to obtain this information – e.g., send an annual questionnaire to each individual requesting the name, title, date and signature of each person and other relevant information.

The new instructions significantly differ with respect to what constitutes "other compensation." Under the prior instructions, filers were required to list all taxable and nontaxable fringe benefits (except de minimis fringe benefits). The new instructions provide a specific list of items to be included, such as –

- tax-deferred contributions by the employer to a qualified defined contribution retirement plan
- tax-deferred contributions by both the employer and the employee to a nonqualified defined contribution plan
- the annual increase in actuarial value of a qualified or nonqualified defined benefit plan
- the value of health benefits that are not included as taxable income. For this purpose, the value of health coverage rather than the actual benefits paid is to be used. Health benefits include employer paid

premiums, health reimbursement arrangements, flexible spending programs, dental, optical, drug, and medical equipment benefits, but they do not include disability or long-term care premiums or benefits.

BUCK COMMENT. *This laundry list of items is more useful than the reference to Publication 525 in the prior instructions. However, the instructions do not provide guidance on valuing health coverage – presumably a COBRA rate could be used.*

There is an exception for items of other compensation that have a value of $10,000 or less. Finally, the instructions provide a chart listing various compensation items and where each should be reported.

Reporting Requirements for Schedule J – Compensation Information

This schedule must be completed if the compensation paid to any of the individuals included in Part VII exceeds $150,000, if former officers, directors, trustees, or key employees are listed in Part VII, or if any individual listed in Part VII received or accrued compensation from any unrelated organization for services to that organization.

Schedule J is divided into three parts. Parts I and II ask a series of questions relating to compensation practices and Part III provides an opportunity to explain these practices.

Part I. The first two questions require organizations to report various forms of compensation provided (e.g., first class or charter travel, companion travel, health or social club dues or initiation fees) and whether these were provided under a written policy and subject to substantiation.

The third question asks how the CEO/Executive Director's compensation was established, i.e., through –

- a compensation committee
- an independent compensation consultant
- Form 990 for other organizations
- written employment contract
- a compensation study or survey
- the approval of the board or compensation committee.

BUCK COMMENT. *Although organizations are not required to provide an explanation of how compensation was determined in Part III of Schedule J, an organization may wish to do so to show transparency to the IRS and other interested parties.*

The fourth question asks whether the listed individuals received other payments, such as from a SERP or other equity-based compensation arrangement. The remaining questions apply only to 501(c)(3) and 501(c)(4) organizations. Questions five and six ask if any contingent compensation payments were based on either growth in revenue or the net earnings of the organization or related organization. The final question asks if there were other non-fixed payments not described in questions five or six.

Part II. Part II requires detailed information for each reported individual on payments from the organization as well as from related organizations. There are columns requiring the breakdown of W-2 and/or 1099-MISC compensation between base pay (column A), bonus or incentive payments (column B) and other compensation (column C). Additional columns require the reporting of current-year deferrals of compensation under qualified and nonqualified plans (column C) and nontaxable benefits (column D) including payments for –

- the value of housing provided by the employer
- educational assistance
- health insurance
- medical reimbursement programs
- life insurance
- disability benefits
- long-term care insurance
- dependent care insurance
- adoption assistance
- payments or reimbursement for certain tax penalties relating to the organization's status, expenses not reasonably incurred in connection with a proceeding related to the person's performance, or expenses resulting from an act or failure to act where the person's actions or inactions were willful and without reasonable cause.

The instructions also describe which nontaxable benefits need not be included on Schedule J. Disregarded benefits include fringe benefits excluded under Code Section 132 (e.g., no additional cost services, de minimis fringe benefits and qualified employee discounts).

> ***BUCK COMMENT.*** *Because the instructions point out that the list of items to be included as nontaxable benefits is not exclusive, employers should review all of their benefit plans and policies to determine which benefits should be included.*

Column E is the totals from the other columns. The final column (column F) requires the organization to list the compensation reported in the prior year's Form 990.

> ***BUCK COMMENT.*** *Because the new Schedule J requires different compensation to be reported as compared to the prior Form 990, the total compensation reported for this tax year may be very different from what was reported on the prior Form 990. If so, an organization may want to explain any differences in Part III.*

Unlike Part VII, Schedule J does exempt compensation that is $10,000 or less.

Part III. In this part, reporting organizations must list the individuals who received the benefits in Part I and a description of the arrangements. In addition, although not required to do so, an organization also can explain other policies, such as the basis for compensation decisions.

> ***BUCK COMMENT.*** *The disclosure of the policies and practices governing compensation as well as the detailed individual information will possibly prompt questions on the part of the media, employees and their representatives, elected officials, and other stakeholders (e.g., alumni of educational institutions or the leaders in communities served by hospitals). In anticipation of those questions, it is suggested that explanations be provided in Part III.*

Conclusion

The new Form 990 requires far more detailed information than in prior years, especially with respect to executive compensation. It will undoubtedly require more time to complete, and it is suggested that organizations begin reviewing the new form and instructions and compiling the needed information as soon as possible. Buck's consultants would be pleased to help you review your compensation practices in anticipation of completing Form 990.