



# BDO Seidman, LLP

# Nonprofit

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## Nonprofit Standard

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## IRS Releases Updated Revised Form 990 Instructions

By Joyce Underwood, CPA

After a lengthy drafting and review process, IRS on August 19th released the final drafts of the redesigned 990 instructions for the 2008 tax year. The new form 990 and its 16 schedules will apply to Form 990s filed for calendar year 2008 returns and fiscal year 2009 returns (2008 tax year/2009 tax season). The forms and instructions still need to go through the internal IRS review and formatting process after which they will be released to the public in final form later this year. No significant additional changes to the forms or instructions are anticipated. On September 9th, in conjunction with the form changes, IRS released temporary regulations (T.D. 9423) to address technical areas that needed to be updated to implement the new 990.

IRS highlighted certain instruction changes included in the August release as follows:

**Key Employees** – The instructions include a revised definition of key employee for purposes of reporting executive compensation, transactions with interested persons, and other items. In general, the three prong definition will require reporting as a key employee only those persons, other than officers, directors, and trustees, who (a) had reportable compensation exceeding \$150,000 for the year (the “\$150,000 test”); (b) had or shared organization-wide control or influence similar to that of an officer, director, or trustee, or managed or had authority or control over at least 10 percent of the organization’s activities (the “responsibility test”); and (c) were within that group of the organization’s top 20 highest paid persons for the year who satisfied both the \$150,000 test and the responsibility test.

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**Foreign Regions** – A list of foreign countries within each of nine geographic regions to be used for reporting foreign activities on the Form 990, Schedule F, Statement of Activities Outside the United States.

**Reasonable Efforts** – Specific reporting requirements for which the reporting organization may rely on reasonable efforts to obtain information required from interested persons or third parties will be limited to (a) Part VI, Governance, Management, and Disclosure, line 1b (determining the number of voting members of the governing body that are independent) and line 2 (determining whether an officer, director, trustee, or key employee had a family relationship or a business relationship with any other officer, director, trustee, or key employee); (b) Part VII, Section A, Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees, line 1a (determining compensation paid to such persons by related organizations); and (c) Schedule L, Transactions with Interested Persons, Part III, Grants or Assistance Benefiting Interested Persons, and Part IV, Business Transactions Involving Interested Persons. The revised instructions provide examples of how the organization may satisfy the reasonable efforts standard with respect to each of these separate reporting requirements.

**Independent Board Member** – The instructions include a revised standard for determining independence of a voting member of the organization's governing body, which replaces the previously proposed “material financial benefit” test by looking to whether the member or a family member was involved in a

transaction or relationship that was reportable on the current year's Schedule L, Transactions with Interested Persons.

**Hospital Reporting** – For Schedule H, Hospital, a revised definition of facility for purposes of completing Part V, Facility Information, for 2008 tax years (2009 filing season). Beginning with 2008 tax years, organizations completing Schedule H will be required to list in Part V each hospital or other facility that is licensed, registered, or similarly recognized by a state as a health care facility, including facilities other than licensed hospitals. This does not alter the definition of hospital for purposes of determining whether the organization must complete Schedule H. The revised Schedule H instructions will also clarify that physician clinics and skilled nursing facilities will be eligible for treatment as a subsidized health service in accordance with the generally applicable rules regarding subsidized health services.

**Tax-Exempt Bonds** – For Schedule K, Supplemental Information for Tax-Exempt Bonds, the revised instructions will provide relief for refunding bonds issued after 2002 to refund pre-2003 bonds, by exempting such refunding bonds from having to be reported in Part III, Private Business

Use. All other parts of the schedule must be completed with respect to such refunding bonds under the generally applicable rules. This change does not alter the generally applicable transition relief for Schedule K, which requires completion of only Part I, Bond Issues, for 2008 tax years (2009 filing season).

In addition to providing copies of the new forms and instructions on their website (<http://www.irs.gov/haritais/article/0,,id=181089,00.html>), IRS has included several background papers summarizing the redesign process, describing how to move from the old to the new form, and summarizing the changes made in response to comments on the draft instructions. The IRS will phase in the new 990 over three years with small organizations being able to file the simpler Form 990-EZ. Organizations that have not had to file 990s in the past due to their gross receipts are subject to IRS' new 990-N electronic file requirement. As the first major rewrite of the 990 form since the 1970s, IRS has made a thorough and comprehensive change to incorporate their goals of enhancing transparency and promoting compliance. Time will tell if their goal of minimizing burden will be met. Many organizations as well as their tax and legal advisors will be kept quite busy interpreting and preparing for the change.

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# Taxation of Employer Provided Cell Phones

By Laura Kalick, JD, LLM in Taxation and Paul Hammerschmidt, CPA

Unless an employee substantiates the business use of a cell phone, the entire value of an employer provided cell phone can be taxed to the employee. This is because communication equipment such as a cell phone is considered “listed property” under the Internal Revenue Code, just like an automobile. Bills have been introduced in Congress<sup>1</sup> that would remove cell phones and similar communication devices from the enumeration of “listed property.” However, rumor has it that it is unlikely that we will see legislative relief in this session of Congress.

When an employer provides listed property to an employee for use in the organization’s business, the benefit of being able to use that property for personal purposes is considered additional compensation. The employee must substantiate the business use in accordance with the accountable plan rules in order to exclude the business use from taxable income and wages. If the business use is not required to be accounted for, the IRS can tax the value of the entire benefit. Furthermore, if the nonprofit is an IRC 501(c)(3) or 501(c)(4), and there is no documentation that shows the benefit was paid as consideration for services, the value of the personal use could also constitute an automatic excess benefit transaction that could be subject to Intermediate Sanctions.

A Technical Advice Memorandum (TAM 200435022) illustrates that unreported personal use of a cell phone could be an excess benefit transaction. In the TAM, the IRS discussed whether Intermediate Sanctions should be imposed on the son of the founder of an or an organization for his use of an organization provided cell phone where the personal use was not reported as income.

IRS concluded that Intermediate Sanctions should be imposed. We note that the TAM involved a unique set of facts, but should nevertheless, not be ignored. In order to avoid tax issues related to employer provided cell phone, organizations should require employee record-keeping of business and personal calls. IRS states on its website:

*At a minimum, the employee should keep a record of each call and its business purpose. If calls are itemized on a monthly statement, they should be identifiable as personal or business, and the employee should retain any supporting evidence of the business calls. This information should be submitted to the employer, who must maintain these records to support the exclusion of the phone use from the employee’s wages.<sup>2</sup>*

Alternatively, an employer can reimburse an employee for the business use of a personal phone. If the employee owns the phone, the listed property requirements do not apply. Any amounts the employer reimburses the employee for business use of the employee’s own phone may be excludable from

wages if the employee accounts for the expense under the accountable plan rules. The accountable plan rules basically require a showing of the business connection, substantiation of the expense and return of any excess advanced amounts.

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<sup>1</sup> See HR 5450, HR 5719 and S2668

<sup>2</sup> <http://www.irs.gov/govt/fgslg/article/0,,id=167154,00.html>

# Good Governance – Best Practices for Nonprofit Organizations

By Laura Kalick, JD, LLM in Taxation

Although initially challenged for its assertive stand to delve into the realm of governance, IRS has defended its position to obtain management and governance information in the new Form 990, based on its responsibility to properly administer the tax laws. IRS believes that a well governed organization is more likely to be in compliance with the tax laws and will even seek to prove the hypothesis by developing a checklist to evaluate the results of examinations to determine if better governance and management would have prevented abuses that they might find when examining an organization.

encourages nonprofit to go through a process to determine reasonable compensation. In fact, the new Form 990 asks all organizations if there is a policy for determining compensation of officers and key employees consisting of approval by independent persons who review comparability data and contemporaneously substantiate the deliberation and the decision.

The new Form 990 has an entire section devoted to Governance, Management and Disclosure. The basis for the inclusion of much of this information is documented in the IRS Governance Paper that provides best practices for 501(c)(3) organizations as follows:

## Governing Body

All organizations can benefit from an active and engaged board. Best practices now say that a board should be “right-sized.” A board that is too big can be cumbersome and one that is too small may not be representative of the public. Most significantly, the board should be relatively independent. If the board is entirely made up on individuals who are not independent of the organization, decision-making may become difficult because of all the conflicts of interest.

## Executive Compensation

One of the key roles that the governing board plays is to review the compensation of key employees. IRS

## Conflicts of interest

Conflicts of interest arise when decisions are made by persons who have interests that compete with the interests of the organization. The Service encourages nonprofits to adopt a written conflict of interest policy that requires individuals to act solely in the interest of the organization and not for their own personal interest. The policy should be regularly evaluated, should identify potential conflicts and require a course of action when a conflict has been identified.

## Investments

More and more nonprofit organizations are entering into complicated and sophisticated investments that require the expertise of investment advisors. IRS suggests that organizations should establish written investment policies that protect the assets of the organization and that compensation of investment advisors should be reasonable. Also, where an organization enters into a

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<sup>1</sup> [http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf)

joint venture with a for-profit entity there should be provisions in the agreements that allow the organization to safeguard its assets.

### **Fundraising**

Fundraising should be done in compliance with federal and state laws. IRS believes that fundraising costs should be kept reasonable.

### **Governing body minutes and records**

The IRS encourages contemporaneous recording keeping of the deliberations of the governing board and any committees that have authority to act on behalf of the board and asks questions on the new Form990 in this regard.

### **Document Retention Policy**

Organizations should establish written document retention policies that cover integrity, retention and destruction of documents. Policies must also be established that cover electronic mail. IRS has recently published IRS Pub 4221, Compliance Guide for 501 (c)(3) Tax-Exempt Organizations, which provides valuable information regarding how long certain documents should be kept.

### **Ethics and Whistleblower Policies**

IRS encourages organizations to adopt a code of ethics that communicates and furthers a culture of legal compliance as well as a whistleblower policy for confidentially handling employee complaints and reporting of suspected financial impropriety or misuse of the organization's resources. The

the Form 990 asks whether the organization became aware during the year of a material diversion of its assets.

### **Financial Statements and Form 990 Reporting**

IRS encourages organizations to have audited financial statements and audit committees to oversee the independence and competence of the auditors. Also, IRS encourages the board of directors, in full or in part, to review the Form 990 before it is filed as part of their oversight duties. The new Form990 asks whether the form was provided to the organization's governing body before it was filed and also the process used to review the form.

### **Transparency and Accountability**

Certain documents are required to be available for public inspection including applications for exemption, Forms 990 and Forms 990-T for 501(c)(3) organizations. In addition, the new Form990 asks whether and how an organization makes available its governing documents, conflicts of interest policy and financial statements to the public.

## **Conclusion**

The new Form 990 will require all nonprofit organizations to provide information about their management and governance policies. Best practices dictate a review of current policies in preparation for the new Form 990.

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## FASB Staff Position No. 117-1

*Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*

**Issued:** 6 August 2008

**Effective date:** Fiscal years ending after 15 December 2008; early application is permitted

### **Provisions:**

There are two main parts to the document:

- A conclusion as to net asset classification under UPMIFA; and
- Enhanced disclosures; **these affect all nonprofits, whether or not they are in a jurisdiction that has adopted UPMIFA, and all endowments, whether donor-restricted or not.**

### **Net asset classification**

The FSP provides as follows:

Paragraph 5. “A not-for-profit organization that is subject to an enacted version of UPMIFA shall classify a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets. Consistent with paragraph 14 of FASB Statement No. 116, Accounting for Contributions Received and Contributions Made, and paragraph 22 of FASB Statement No. 117, Financial Statements of Not-for-Profit Organizations, the amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization’s governing board determines must be retained (preserved) permanently consistent with the relevant law.”

This may or may not require any reclassification of present amounts. Note the reference to the governing board’s interpretation of the law. Presumably clients will wish to obtain legal advice on this point.

The FSP also provides the following:

Paragraph 8. “For each donor-restricted endowment fund for which the restriction described in subsection 4(a) of UPMIFA is applicable, a not-for-profit organization shall classify the portion of the fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure by the organization.”

This paragraph is a departure from present practice by many organizations, and may require that certain amounts be reclassified by some organizations from unrestricted to temporarily restricted net assets (per Paragraph 17 of the document).

### **Enhanced disclosures**

The proposed disclosures are quite extensive, and are set forth in Paragraphs 11 and 12:

11 “At a minimum, an organization shall disclose the following information for each period for which the organization presents financial statements:

- a. A description of the governing board’s interpretation of the law(s) that underlies the organization’s net asset classification of donor-restricted endowment funds.

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- b. A description of the organization's policy(ies) for the appropriation of endowment assets for expenditure (its endowment spending policy(ies)).
  - c. A description of the organization's endowment investment policies. The description shall include the organization's return objectives and risk parameters; how those objectives relate to the organization's endowment spending policy (ies); and the strategies employed for achieving those objectives.
  - d. The composition of the organization's endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor-restricted endowment funds separately from board-designated endowment funds.
  - e. A reconciliation of the beginning and ending balance of the organization's endowment, in total and by net asset class, including, at a minimum, the following line items (as applicable): investment return, separated into investment income (for example, interest, dividends, rents) and net appreciation or depreciation of investments; contributions; amounts appropriated for expenditure; reclassifications; and other changes.
- 12 In accordance with the requirements of Statements 117 and 124, an organization also shall provide information about the net assets of its endowment funds, including:
- a. The nature and types of permanent restrictions or temporary restrictions (paragraphs 14 and 15 of Statement 117)
  - b. The aggregate amount of the deficiencies for all donor-restricted endowment funds for which the fair value of the assets at the reporting date is less than the level required by donor stipulations or law (paragraph 15(d) of Statement 124)."

Appendix C to the document contains illustrative disclosures.

(Some of the proposed disclosures included in the exposure draft were dropped from the final document.)

Organizations with endowment funds - whether donor-restricted or board-designated - should start now to gather the information needed to make these disclosures, as this may require changes to how data are accumulated and summarized by their accounting systems.

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The complete text of the FSP is at:

[http://www.fasb.org/pdf/fsp\\_fas117-1.pdf](http://www.fasb.org/pdf/fsp_fas117-1.pdf)

A summary of the enactment status of UPMIFA is at:

<http://www.upmifa.org/DesktopDefault.aspx?tabindex=5&tabid=68> (Obviously this is subject to change.)

The text of UPMIFA is at:

[http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final\\_act.pdf](http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf)

However, each state's version of the law should be reviewed for its applicability in that state.