

Tax Exempt Organizations: It's Time to Evaluate Your Governance Policies and Procedures

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The emergence of the new revamped Form 990, Return of Organization Exempt from Income Tax, has created a heightened awareness by many tax exempt organizations to review their existing governance policies and procedures. Amongst its many revisions, Form 990, currently in effect, contains a new section that requests information regarding the organization's governing body, management, policies, and disclosure practices. The connection between much of the information requested under this new section and the requirements for an organization to obtain or maintain tax exempt status may seem tenuous but charitable organizations which are exempt under IRC § 501(c)(3) must operate exclusively for specified exempt purposes and its earnings can not inure to any individual. The Internal Revenue Service ("IRS") does not require any specific written policies or management structure, but failure to have such policies or structures in place may put the organization at risk. The IRS believes that the answers to these new detailed questions provide insight into potential areas of risk related to non-compliance and abuse within tax exempt organizations. The breadth and impact of the IRS' inquisitive probing without the mandate to require tax exempt organizations to have certain policies and procedures in place go well beyond IRS scrutiny. Although failure to implement certain policies and

procedures may invite the IRS for a closer look into a tax exempt organization's operations, the exposure is even greater because Form 990 is open to public inspection. Accordingly, how an organization responds to the questions in Form 990, may influence how much, if anything, potential donors are willing to contribute to a specific tax exempt organization.

The new section Part VI of Form 990 appears to place tax exempt organizations in alignment with the mandated requirements for publicly traded companies under the Sarbanes-Oxley Act ("SOX"). In 2002, the enactment of SOX set sweeping changes to the corporate world by altering the corporate governance landscape for public companies. SOX has placed management responsibility and objectivity on the governing board, has required independence and accountability for the board and has also imposed auditing procedures on publicly traded companies to ensure integrity in the company's operations. With the exception of document retention policies and whistleblower protection policies, the requirements under SOX are not applicable to tax exempt organizations. Nevertheless, Part VI of Form 990 requests information that pertains to accountability and independence inquiries, which appear to be similar to SOX requirements.

Below is a list of some of the inquiries listed on Part VI of Form 990:

- if the organization has delegated control over management duties;
- if there was a material diversion of the assets of the organization such as an unauthorized conversion or use of assets other than for the organization's authorized purposes;
- whether the organization contemporaneously documents the meetings of its governing body and committees;
- whether members of the organization's governing body have reviewed the completed Form 990 to be submitted to the IRS and a description of the process the organization uses to review Form 990;
- whether the organization has certain policies and procedures in place, such as a conflict of interest policy, a whistleblower policy, and a document retention and destruction policy;
- a description of the process the organization undertakes to monitor and enforce compliance with a conflicts of interest policy;
- a description of the process for determining compensation for top management officials and other officers or key employees of the organization;
- whether an organization participates in any joint venture with a taxable entity during the year and if so, if the organization has adopted a written policy or procedure requiring it to evaluate its participation in the joint venture according to federal tax law, and whether it has taken steps to safeguard its tax-exempt status; and
- a description of whether the organization makes its governing documents, conflict of interest policy and financial statements available to the public.

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The prior version to Form 990 did not address this level of detail regarding a tax exempt's governance. As evidenced by the new inquiries, the current Form 990 focuses heavily on accountability and integrity. The IRS believes that the adoption of many of these policies help to ensure that a tax exempt organization is operating in a manner that is consistent with its exempt purposes.

The importance of integrity and accountability are highly significant qualities for tax exempt organizations to embody. Donations may be based upon the perception that a tax exempt organization is accountable and operates with integrity. Potential donors may request a copy of Form 990 as part of their due diligence process before making a decision to donate. Because the new Form 990 provides more detailed information about the organization's governance, the information reported may play a prominent role in a donor's decision. If a potential donor reviews a Form 990, where an organization has checked the "no" box for having a conflict of interest policy, that potential donor may conclude that the organization conducts insider deals with its board members; thus, swaying the potential donor from contributing to that particular organization. Therefore, it is imperative that each tax exempt organization work with its legal counsel to consider adopting many of the policies suggested by the IRS.

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