

OVERVIEW

On February 12, 2010, the IRS released the updated 2009 Form 990, schedules and instructions, which apply to fiscal years that begin in 2009. The 2009 changes address several critical areas including the governance, compensation and interested person transaction sections. These updates to the recently revised Form 990 provide additional direction on key governance and compensation questions, reporting items and disclosures. The changes give further evidence that the IRS continues to reinforce the need for better transparency and good governance.

This *Compensation Insight* focuses on the changes to the governance, compensation and interested persons disclosures, which apply to the 2009 fiscal year filing. The updates are as follows:

I. Governance: Three Updates

Part VI: Governance, Management and Disclosure

Section A. The Governing Body and Management section requests information about an organization's governing body, management, governance policies and disclosure requirements.

UPDATE 1

Line 2 asks whether any officer, director, trustee or key employee has a family relationship or business relationship with any other officer, director, trustee, or key employee of the filing organization.

The IRS indicates that a business relationship between two people exists if any of the following apply: (1) One person (who is an officer, director, trustee or key employee) is employed by a business where the other is an officer, director, trustee, key employee or greater than 35% owner; (2) One person (who is an officer, director, trustee or key employee) is transacting business with another and participates in transactions involving cash or transfer of property in excess of \$10,000 in aggregate per year; (3) Two people are each a director, trustee or officer, or more than a 10% owner in the same business or investment entity.

The IRS has clarified that if two individuals serve as an officer, director, trustee or key employee in similar positions with another tax exempt organization, that this does not create a reportable relationship for the organization.

Section B. Policies

While the IRS states that Section B covers policies that are not required under the Internal Revenue Code, the IRS considers the policies and procedures described in this section to improve tax compliance. The IRS states that the absence of appropriate policies can lead to activities inconsistent with tax exempt status. Therefore, it is important that every organization carefully consider adopting them.

The IRS now expressly permits the filer to answer "Yes" when it e-mails a copy of the entire Form 990 to each voting member of the board. It is also acceptable to make it available to all voting members through a password protected website portal with a notice to board members that it is available.

UPDATE 2

Line 11 asks whether the organization provided a copy of the Form 990 to all members of its governing body before filing the form.

UPDATE 3

Line 15 asks whether the process for determining compensation for the organization's disqualified individuals was conducted in a manner that is consistent with the requirements needed to establish the rebuttable presumption of reasonableness.

The IRS has clarified that the definition of "independent" board members used here will be the same as the term "disinterested" board members referenced in the regulations describing how to establish a rebuttable presumption of reasonableness.

Specifically, the IRS asks whether the process for determining compensation for the organization's CEO, executive director, top management officials, other officers or key employees includes a review and approval by **independent persons**, using comparability data and contemporaneous substantiation of the deliberation and decisions.

For purposes of this question, the IRS indicates that a member of the approving body will be disinterested with respect to compensation provided if:

- The member (or family member of the member) is not participating in or benefiting from the compensation arrangement.
- The member does not have an employment relationship subject to the direction or control by any person participating in or benefiting from the compensation arrangement.
- The member does not receive compensation or other payments subject to the approval of any person participating in or economically benefiting from the compensation arrangements.
- The member does not have a material financial interest affected by the compensation arrangement.

- The member does not approve a transaction providing economic benefits to any person participating in the compensation arrangement that in turn has or will approve a transaction providing economic benefits to the member.

SUMMARY

If there is a question as to whether any of these circumstances apply, organizations should review the specific facts and circumstances with their legal counsel to determine whether the relationships or transactions are significant enough to jeopardize the disinterested status of a board member involved in compensation decision-making.

II. Compensation: Four Updates

Part VII: Compensation of Key Individuals

Section A and Schedule J require the listing of officers, directors, trustees, key employees and highly compensated employees, and disclosure of certain compensation information. Compensation must be reported for:

- All officers, directors and trustees, regardless of compensation.
- Current key employees with over \$150,000 of reportable compensation.
- Current five highest compensated employees other than officers, directors, trustees or listed key employees with compensation over \$100,000.
- Former officers, key employees and highest compensated employees, if over \$100,000 of reportable compensation is provided.
- Former directors and trustees, if over \$10,000 of reportable compensation is provided in their capacity as a former director or trustee.

UPDATE 1

The IRS clarifies that if a person is a "key employee" at any time during the year, that person must be treated as a key employee for purposes of reporting compensation.

UPDATE 2

If a person is a “key employee” for only a part of the tax year, the filer must report that person’s entire compensation for the calendar year ending with or within the tax year.

UPDATE 3

If an organization is leasing an individual who is an officer, director, trustee, key employee or one of the five highest paid employees, or if they received compensation or payments from another organization, those amounts must be reported in the Form 990.

UPDATE 4

Schedule J, line 8 asks whether the organization used the “**initial contract exception**” under the intermediate sanctions rules. If the answer is “yes,” the IRS asks whether the organization also followed the rebuttable presumption of reasonableness process for the same compensation arrangement.

SUMMARY

The IRS further defines who will be included in the compensation section of the Form 990 and reinforces the establishment of a rebuttable presumption of reasonableness as a best practice.

SUMMARY

The IRS remains interested in the disclosure of joint ventures and the dollars that are invested and paid through them.

What Do These Updates Mean to your Organization?

In light of these new developments, SullivanCotter suggests that all not-for-profit organizations that file a Form 990 consider the following actions:

- Familiarize yourselves with the changes to Form 990, and inform the board of the updates in advance of filing the 2009 Form 990.
- Review the processes in place to ensure the board will have access to the full Form 990.
- Review compensation committee relationships to ensure that each committee member meets the disinterested definition, and where necessary, take action or develop procedures to avoid conflicts that may threaten a compensation committee member’s disinterested status.
- Continue to review executive compensation in a manner that ensures the establishment of a rebuttable presumption of reasonableness.
- Review all joint ventures for applicability of the new reporting requirements.

For more information on the potential impact of these updates on your organization, contact a SullivanCotter consultant today.

III. Transaction with Interested Parties:

Two Updates

Schedule L: Business Transactions

Part IV: Joint Ventures explains how to report joint ventures with interested persons as business transactions.

UPDATE 1

If the organization and an interested person participate in a reportable joint venture in which each has profits or capital exceeding 10% of the total, the organization has to disclose the cumulative amount invested as of the end of the reporting year, even if nothing was invested in that year.

UPDATE 2

The IRS clarifies that governmental units are not interested persons.

About Sullivan, Cotter and Associates, Inc.

Sullivan, Cotter and Associates, Inc. is an independent consulting firm specializing in the assessment and development of strategic total compensation programs for not-for-profit healthcare clients. Since 1992, SullivanCotter has worked closely with not-for-profit healthcare organization boards, compensation committees and management to devise innovative compensation solutions that attract and retain leadership and physician talent and that comply with regulatory standards and best corporate governance practices. A leader in compensation consulting and benchmarking, SullivanCotter annually conducts the most widely recognized healthcare executive and physician compensation surveys in the United States.

SullivanCotter has offices in Atlanta, Boston, Chicago, Detroit, Minneapolis, New York, Parsippany, San Francisco, Washington, D.C. and Westport.

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