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IRS Publishes New Tax-Exempt Organization Guidelines

On July 23, 2009, the Internal Revenue Service (IRS) released new governance training materials to provide guidance to agents concerning key issues to scrutinize when reviewing the governance of nonprofit hospitals and other exempt organizations by their controlling groups (e.g. boards of directors or boards of trustees). These new guidelines are part of the IRS's aggressive promotion of its message that good governance practices are a critical component of a tax exempt organization and promote compliance with tax law.[1] Through these new training guidelines, the IRS hopes to lessen the perceived disconnect between their message and the work done by their field agents.[2] The guidelines clarify that it should be state Attorneys General who regulate nonprofit governance, and not the IRS. As such, there is no IRS mandate that a specific governance policy or practice is a prerequisite to obtaining or maintaining exemption.[3] This new material is part of a trend of increased IRS scrutiny of exempt organization governance dating from early 2007 when it posted the Preliminary Staff Discussion Draft on good governance practices, used to create the governance section of Form 990.[4]

The guidelines include new training materials reinforcing that "one size does *not* fit all" for governance issues, and vary depending upon the type size, structure, and culture of the organization.[5] There is a substantial focus on educating agents about governance structures, recognizing governance issues and ongoing oversight efforts, including the use of the Form 990 questions in developing compliance initiatives.[6] These initiatives will allow the IRS to explore any correlation between governance and compliance with tax laws and will be used in a later project to develop additional compliance tools using input from exam agents and outside stakeholders.[7]

The new guidelines make it clear that the duty of the IRS is to assess whether an organization is compliant with tax law. In addition to looking for general noncompliance, IRS agents will examine whether organization managers participated in decisions resulting in excess benefits or whether the organization took certain steps to ensure the fairness of the arrangement to the exempt organization.[8] Agents will also use the newly revised Form 990 to provide public transparency concerning an organization's governance structure, policies, and activities.[9] Part VI of the form relates to governance and is divided into three parts: governing body management policies, disclosure, and transparency of certain information. The new changes to Form 990 include:

- Exempt purpose and mission;
- Number, composition, qualifications, authority, or duties of officers, key employees or voting members;
- Role of stockholders or membership in governance;
- Distribution of assets upon dissolution;
- Provisions to amend documents;
- Quorum, voting rights or voting approval requirements;
- Policies / procedures regarding compensation of officers, directors, trustees or key employees; conflicts of interest, whistleblowers, or document retention / destruction; and
- Composition or procedures contained within organizing documents or bylaws of an audit committee.[10]

These questions (especially regarding compensation) have traditionally been for charitable organizations, but the IRS will now ask all organizations seeking exempt status Form 990 questions and require responses to them.[11] Compensation and other financial arrangements with the applicant organization's officers, directors, trustees, employees and independent contractors are also detailed in part V of Form 1023.[12] Form 990 will also be used as a tool for future compliance efforts by the IRS.[13]

The new guidelines can also be a reference for nonprofit organizations as they publicly emphasize areas of interest that have not been pronounced before, such as: an active and engaged board; appropriate board size and composition of primary independent members; mechanisms for allocating authority between board members and directors; mechanisms for documentation; and key policies addressing conflicts, whistleblower issues, document retention, compensation, and investments.[14]

While the IRS does not mandate any specific procedures, these new areas of interest demonstrate that

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the IRS is expanding its reach into all aspects of an exempt organization's operations. In special cases, the IRS will impose certain rules concerning board composition. Additionally, for tax-exempt hospitals the IRS will not allow the board to be dominated by the medical staff physicians. Overall, healthcare organization boards that are seeking tax exempt status or looking to renew existing status should be aware of increased governance and scrutiny by the IRS.

[1] Source: "The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues" By Bonnie S. Brier and Ana Thompson, Advisory Committee on Tax Exempt and Government Entities, June 11, 2008, p.1, 6.
[2] Source: "Exempt Organizations: IRS Releases Governance Training Materials, Provides Agents With Needed Exam Guidance," BNA Health Law Reporter, Vol. 18 (July 30, 2009) p. 1009.
[3] Source: "Exempt Organizations: IRS Releases Governance Training Materials, Provides Agents With Needed Exam Guidance," BNA Health Law Reporter, Vol. 18 (July 30, 2009) p. 1009.
[4] Source: "The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues" By Bonnie S. Brier and Ana Thompson, Advisory Committee on Tax Exempt and Government Entities, June 11, 2008, p.1, 6.
[5] Source: "EO Determinations CPE: Governance" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p. 4.
[6] Source: "Exempt Organizations: IRS Releases Governance Training Materials, Provides Agents With Needed Exam Guidance," BNA Health Law Reporter, Vol. 18 (July 30, 2009) p. 1009.
[7] Source: "Exempt Organizations: IRS Releases Governance Training Materials, Provides Agents With Needed Exam Guidance," BNA Health Law Reporter, Vol. 18 (July 30, 2009) p. 1009.
[8] Source: "Governance and Tax-Exempt Organizations: 2009 CPE Training" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p.5.
[9] Source: "Governance and Tax-Exempt Organizations: 2009 CPE Training" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p.27.
[10] Source: "EO Determinations CPE: Governance" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p. 43.
[11] Source: "EO Determinations CPE: Governance" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p. 61.
[12] Source: "EO Determinations CPE: Governance" Internal Revenue Service, Handout, July 23, 2009, p. 14.
[13] Source: "EO Determinations CPE: Governance" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p. 43.
[14] Source: "EO Determinations CPE: Governance" Internal Revenue Service, PowerPoint Presentation, July 23, 2009, p. 28.

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