

8. Nonprofit Board Members Face Increased IRS Scrutiny *

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By Marc E. Craft, CPA

Lexington, KY - Those of us who serve on nonprofit boards are now under closer scrutiny from the Internal Revenue Service. The IRS, at the direction of Congress, is making a concerted effort to address abuses in the nonprofit sector ranging from excess compensation and benefits to inflating values of donations received. It is focusing on whether nonprofit boards are complying with their fiduciary responsibilities to the organizations they serve. While the IRS has had the ability to enforce sanctions against nonprofit organizations and their managers in addressing prohibited and excess benefit transactions, it is requiring much more disclosure and transparency in nonprofit reporting and is expecting the boards of tax-exempt organizations to become more actively involved in management. The days of the "figurehead" board member who attends a board meeting once or twice a year and knows little about the organization's operations are over.

One of the major tools to increase this transparency is the revised Form 990 – Return of Organization Exempt From Income Tax. This is the form filed annually by most nonprofit organizations. The form had not been significantly revised since 1979, and the IRS has certainly made up for lost time. The instructions for the 11-page form are 76 pages long. In addition to reporting the organization's revenues and expenses, the form requires the identity of all officers and directors; any compensation or expenses paid to or on a director's behalf; and the amount of time spent weekly performing director responsibilities.

The Form 990 has a separate section, Part VI, entitled "Governance, Management, and Disclosure." This section contains a series of questions asking if the organization has controls in place to govern transactions between a board member and the organization; policies for determining compensation of directors and management; and, most importantly, whether a copy of the Form 990 was given to members of the governing body prior to its filing. In addition, the form requires the organization to describe on Schedule O management's method for reviewing the Form 990.

If you are a board member of a nonprofit entity and missed the last couple of meetings, haven't read the financial statements for a year or so, and voted for that 20-percent wage increase for the sister of the executive director, then the above is probably starting to make you feel a little squeamish. Wait, there's more. Much of the information provided through Form 990 and its schedules will provide the IRS with information to pursue nonprofit organizations who actively or through omission allow certain employees, managers, or directors to engage in unlawful activities. As mentioned earlier, the IRS has the authority to enforce sanctions against nonprofit organizations and its managers when the law has been violated. These sanctions include the imposition of excise taxes on responsible parties or the revocation of the organization's tax-exempt status. The excise taxes are imposed if an applicable tax-exempt organization provides an excess benefit to a disqualified person and that benefit exceeds the benefit an organization received in the exchange. The IRS' definition is far-reaching and includes any person in a position to exercise substantial influence over the affairs of the organization. The definition also applies to any family member of this person.

The excise tax on an excess benefit transaction is assessed against the disqualified person and the tax is equal to 25 percent of the excess benefit. If the excess benefit transaction is not corrected within 90 days, an additional 200 percent tax is assessed against the disqualified person. Finally, any organization manager who approved the transaction is subject to a 10 percent tax based upon the excess benefit amount not to exceed \$20,000 per transaction. In addition, there is joint and several liability for the tax, meaning a person could be liable for both the tax assessed the disqualified person and the organization manager tax.

For determining the excise tax for organization managers, the IRS states, "... an organization manager is considered to be any officer, director, or trustee of an applicable tax-exempt organization, or any individual having powers or responsibilities similar to officers, directors, or trustees." Furthermore, a person knowingly

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participates in the transaction if the person, "... has actual knowledge of sufficient facts so that, based solely upon those facts, such transaction would be an excess benefit transaction or negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction." As a result, the "see no evil, hear no evil" approach or the conveniently ignorant defense will not work in this situation.

A committed individual should not be afraid to serve on a tax-exempt organization's board. Board service is an important and valuable community service. However, it is now more important than ever that board members or prospective board members of nonprofit organizations be diligent in their approach to fulfilling their director responsibilities and be willing to commit the time to do such. Board members should make it a point to educate themselves about the activities of the organization and other similar organizations; review budgets and financial statements; examine the profitability of fundraising ventures; document the work of committees; establish policies to cover conflicts of interest and other matters; review the organization's salary and benefit structures; and, most of all, not be afraid to ask questions.

Posted by **Leuyen Dinh** on Friday, February 06, 2009

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- Call: (202) 622-4000
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