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Client Alert

January 16, 2008

New Form 990 Signals More Intense IRS Scrutiny of Compensation for Tax-Exempt Organizations

Tax-exempt organizations face significantly expanded disclosure of executive compensation programs and related Board policies in the 2008 tax year under new IRS rules. As a result, potential donors are more likely to review pay programs with greater scrutiny. The changes to Form 990 (unveiled by the IRS on December 20, 2007) represent the first major revisions in reporting standards since 1979, and parallel an ongoing drive by the SEC to make the workings of high-level pay programs more transparent to investors in public companies. Non-profit Boards should be aware that complying with the new Form 990 will require a significantly heightened level of attention to the details of executive compensation programs and the process by which decisions are reached.

Details that tax-exempt organizations will need to report in the redesigned Form 990 and related schedules **(http://www.irs.gov/charities/article/0,,id=176637,00.html)** include, among others:

- Which executives received more than a certain level of reportable compensation
- Certain payments made to former executives and officers
- Perquisites provided to executives such as first class travel, health club membership or maid service
- A narrative explanation of how decisions about compensation are reached
- Information about the independence of Board members
- Whether the Board utilized the services of a compensation consultant

Basic Structure

The new Form 990 will consist of:

- **A Summary Page** that provides a snapshot of the organization's key financial, governance and operating information, as well as a summary of its mission or significant activities.
- **A Core Form** that describes the organization's mission, program services and accomplishments in a narrative format, along with quantitative data about compensation provided to top executives.
- **16 Schedules** that must be provided if the organization conducts certain activities. Most significantly, a new Schedule J will report more specific data and narrative in regard to executive pay practices than previously required.

Compensation Reporting and Schedule J

Compensation is disclosed in the Core Form as reported on the executive's Form W-2 or Form 1099-MISC. All organizations now will have to report on a calendar year basis, as compared with their previous flexibility to report on either a calendar or fiscal year basis.

In addition to the Core Form, organizations must file a new Schedule J, "Supplemental Compensation Information," if they have certain officers, directors, trustees, and key employees whose level of pay as reported in the Core Form compensation table is in excess of either:

- $150,000 reported as W-2 income, or
- $250,000 of total compensation, nontaxable benefits and expense reimbursements.

For those executives, Schedule J poses a series of more specific questions and, for certain types of compensation, tabular and narrative information. Among the new areas of disclosure:

- Expenses or services provided for:
  - Travel for companions
  - Tax indemnification
  - Gross-up payments
  - Housing allowances
  - Personal services, such as a maid or chef

- Whether the organization has written governance policies for such expenses or services
- How the organization determined compensation for its CEO/Executive Director, including:
    - Whether programs were approved by the Board or the Compensation Committee
    - Whether an independent compensation consultant was utilized
- Other types of compensation such as:
    - Severance or change-in-control payments
    - Supplemental nonqualified retirement plans
    - Equity-based compensation arrangements
    - Compensation contingent on the organization's revenue or net earnings
- Quantification in tabular format of the following amounts (excluding de minimus fringe benefits and expense arrangement amounts):
    - Base
    - Bonus and incentive compensation
    - Other compensation
    - Deferred compensation
    - Nontaxable benefits
    - Total compensation (the sum of the above components)
    - Compensation reported in the prior year's Form 990 (for comparison purposes)

Effective Date and Transition

The new Core form and Schedules must be used starting with the 2008 tax year, to be filed in 2009. There is a three-year graduated transition period for smaller organizations, during which they may file the Form 990-EZ instead of the Form 990.

The IRS expects to have instructions for the new form ready in early 2008.

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