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IRS Releases FAQ on Compensation Section of Exempt Organizations' Annual Return.

The IRS has released a list of frequently asked questions on sections of the exempt organization return that focus on the compensation of officers, directors, trustees, key employees, and independent contractors.

Exempt Organizations Annual Reporting Requirements — Form 990,

Part VII and Schedule J — Compensation Information

The questions below relate to Schedule J (Compensation Information) and Part VII (Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors), Form 990, Return of Organization Exempt From Income Tax.

A. Questions for All Filers

1. Which persons must be listed as officers, directors, trustees, key employees and five highest compensated employees on Part VII of Form 990?

The organization must list all of its current officers, directors and trustees, as those terms are defined in the Glossary in the instructions, regardless of whether any compensation was paid to such individuals. The organization must also list up to 20 current employees who satisfy the definition of key employee (persons with certain responsibilities and reportable compensation greater than \$150,000 from the organization and related organizations), and its five current highest compensated employees with reportable compensation greater than \$100,000 from the organization and related organizations who are not officers, directors, trustees or key employees of the organization.

Special filing amounts and requirements apply for a former—a person who was an officer, director, trustee, key employee or one of the organization's five highest compensated employees, in one of the five prior reporting years.

TIP: All filing organizations (not just section 501(c)(3) organizations) must list and report compensation paid to the organization's five highest compensated employees with reportable compensation greater than \$100,000 from the organization and related organizations, as well as to its five highest compensated independent contractors to which the organization paid more than \$100,000 for services. See Part VII and related instructions.

2. Form 990 reporting requirements refer to reportable compensation and other compensation. How does an organization know which types and amounts of compensation are included in each, and where to report these types and amounts on the form?

Reportable compensation generally means compensation reported in Box 5 of the employee's Form W-2, or in Box 7 of a non-employee's Form 1099-MISC. Special rules apply if an employee does not have any amount reported in Box 5 of Form W-2. Other compensation generally means compensation

that is not reportable compensation. The instructions to Part VII explain these terms, and also provide a table listing various types of compensation and where to report them in Part VII or in Schedule J. A specific type of other compensation that is less than \$10,000 for a given person does not need to be reported in Part VII, except tax-deferred contributions by the employer to a defined contribution retirement plan, the annual increase in the actuarial value of a defined benefit plan, and the value of health benefits not includible in reportable compensation. This \$10,000 exception only applies to reporting in Part VII of Form 990; it does not apply to Schedule J.

TIP: As stated above, the \$10,000 exclusions for reporting related organization compensation (described in Reporting Compensation Paid by Related Organizations) and certain types of other compensation (described in this Q&A) apply only to Part VII reporting, and are not available for Schedule J reporting. Accordingly, the compensation amounts required to be reported on Schedule J may exceed the amounts required to be reported on Part VII for the same person. Organizations are not required to use the available reporting exclusions for Part VII. Organizations that prefer to report the same total reportable compensation and other compensation amounts in both Part VII and Schedule J for a person listed in Schedule J may do so by reporting otherwise excludible amounts in Part VII.

3. Schedule J, Part VII, contains questions about an organization's executive compensation practices and policies. Are these questions to be answered for all of the persons listed in Form 990, Part VII, or only those persons listed in Schedule J, Part II?

Question 3 of Schedule J, Part I, must be answered with respect to the organization's top management official (e.g., CEO/Executive Director). All other Part I questions are to be answered for all persons listed in the core form Part VII, not just those also required to be listed in Schedule J.

4. The organization uses a fiscal year as its tax year for completing Form 990. May it report executive compensation in Part VII based on its fiscal year, rather than the calendar year amounts reported on Form W-2 or Form 1099?

No. A fiscal year filing organization must report amounts in Form 990, Part VII, as well as any amounts reported in Schedule J, on the calendar year ending with or within the organization's fiscal year. This is the same requirement for organizations filing a Form 990 on a calendar year basis.

TIP: In contrast to the calendar year reporting required in Part VII, an organization filing Form 990 for a fiscal year must report compensation expense amounts in its Statement of Expenses (Part IX of Form 990) based on its fiscal year.

5. How should an organization list in Part VII, Form 990, a person who is a current officer or director for part of the year and a former officer or director for the rest of the year — as a current, former or both? What about persons who are key employees or highest compensated employees for only part of the year?

The filer should list in Part VII, Section A, Form 990, any person who was a current officer or director at any time during the tax year, even if the person is not an officer or director at the end of the year. All of that person's compensation from the organization should be listed in Part VII, Section A, whether received as a current officer or director, a former officer or director or in another capacity (e.g., independent contractor). A current key employee or highest compensated employee is a person who was a key employee or highest compensated employee for the calendar year ending with or within the organization's tax year, even if he or she is not an employee of the organization at the end of that year. A former officer, director, trustee, key employee or highest compensated employee should be listed in Part VII, Section A, only if such person is not listed in Part VII, Section

A, in any other capacity.

6. Under what circumstances must compensation paid by a related organization be reported on Form 990?

For purposes of Form 990, related organization generally means a parent, subsidiary, brother or sister organization under common control, a sponsoring organization of or contributing employer to a voluntary employee beneficiary association (VEBA), or a section 509(a)(3) supporting or supported organization of the filing organization. An organization need not list individuals who are officers, directors, trustees, key employees or the five highest compensated employees of a related organization unless that person also serves in one or more of these capacities with the filing organization. Once a person is required to be listed in Part VII, Section A, however, compensation paid by a related organization to such person generally must be reported in Part VII if it equals or exceeds \$10,000 from that organization. The \$10,000 exception for amounts paid by a related organization only applies to reporting in Part VII of the core form; it does not apply to Schedule J.

7. The reporting requirements refer to reportable compensation and other compensation. Which types and amounts of compensation are included in each, and where should we report these types and amounts on Form 990?

Reportable compensation generally means compensation reported in Box 5 of the employee's Form W-2, or in Box 7 of a non-employee's Form 1099-MISC. Special rules apply if an employee does not have any amount reported in Box 7 of Form W-2. Other compensation generally means compensation that is not reported on Forms W-2 or 1099. A specific type of other compensation that is less than \$10,000 for a given person does not need to be reported in Part VII, except tax-deferred contributions by the employer to a defined contribution retirement plan, the annual increase in the actuarial value of a defined benefit plan, and the value of health benefits not includable in reportable compensation. This \$10,000 exception only applies to reporting in Part VII of Form 990; it does not apply to Schedule J.

The instructions to Part VII explain these terms, and also provide a table listing various types of compensation and where to report them in Part VII and in Schedule J.

TIP: As stated above, the \$10,000 exclusions for related organization compensation and certain types of other compensation (described above) apply only to Part VII reporting, and are not available for Schedule J reporting. Accordingly, compensation amounts required to be reported on Schedule J may exceed amounts required to be reported on Part VII for the same person. Organizations are not required to use the available reporting exclusions for Part VII. Organizations that prefer to report the same total reportable compensation and other compensation amounts in both Part VII and Schedule J for a person listed in Schedule J may do so by reporting otherwise excludable amounts in Part VII.

8. Form 990, Part VII, Section A instructions say to list persons in a particular order, beginning with trustees or directors, followed by officers, then key employees, then highest compensated employees, then former such persons. Why should these persons be listed in this order?

If a person is a director, trustee or officer of the organization, he or she cannot be listed as a key employee of that organization in Part VII of Form 990. Accordingly, officers, directors or trustees should be listed in Part VII before the organization determines which key employees to list. Likewise, in determining its five highest compensated employees who received more than \$100,000 of reportable compensation, the organization is not to consider persons who are already listed in Part VII as officers, directors, trustees or key employees of the organization.

9. Because some of our managers report to the CEO or other executives, they don't have ultimate authority over the organization, so we don't need to report them as key employees on Form 990, right?

The answer depends on whether those employees manage a discrete segment or activity of the organization that represents 10 percent or more of the organization's assets, income, activities or expenses, or whether they have authority to control or determine 10 percent or more of the organization's capital expenditures, operating budget or employee compensation. If so, and if their reportable compensation from the organization and related organizations during the tax year exceeds \$150,000, then they must be reported as key employees. If the organization has over 20 employees who meet these tests, then it would only report the top 20 most highly compensated as key employees.

Additional information:

Form 990, Return of Organization Exempt From Income Tax

Form 990 instructions

10. Are all organizations that list individuals in Form 990, Part VII also required to complete Schedule J?

No. An organization is required to complete Schedule J only if it satisfied at least one of three separate requirements:

1. It is required to list any former officer, director, trustee, key employee or highest compensated employee in Part VII, Form 990;
2. The sum of reportable compensation and other compensation paid to any individual listed in Part VII by the filing organization and related organizations exceeds \$150,000, or
3. It participated in an arrangement in which compensation was paid by an unrelated organization to at least one of its officers, directors, trustees, key employees or five highest compensated employees for services provided to the filing organization.

The thresholds for completing Schedule J are contained in Questions 3-5 of Part VII, Section A.

TIP: Organizations required to complete Schedule J are not required to list and report compensation for all individuals listed and reported in core form Part VII. They only must list and report in Schedule J, Part II, those individuals who receive compensation for the tax year that exceeds the applicable reporting thresholds described in Questions 3-5 of Part VII, Section A (e.g., \$150,000 for current officers, directors, trustees and key employees).

11. Some amounts reported on Form 990 as current year compensation may have also been reported in a prior year's Form 990 or 990-EZ. This could overstate the cumulative compensation reported as paid to the individual. May the organization back out this duplicate amount on the current year's form?

Part VII core form reporting does not permit amounts to be backed out if they were reported in a prior filing of Form 990; such double reporting may be explained in Schedule O. However, for persons listed in Schedule J, column (F) of that schedule allows for a backing out of duplicate amounts that were included in the current year's reportable compensation amount as well as in a prior year's Form 990 filing. This may occur for compensation deferred in a prior year but paid in

the current year. This allows the organization to depict more accurately the cumulative compensation paid to individuals listed on Schedule J.

12. May an organization report base pay at full amount on Form 990, Schedule J, including deferrals to 401(k) and 403(b) plans, rather than separating deferrals from other base pay and reporting them in Schedule J as other reportable compensation?

A table in the core Form 990 Part VII instructions indicates that employee deferrals to 401(k) and 403(b) plans should be reported in other reportable compensation on Schedule J, column (B)(iii). The sum of the amounts reported by the organization for an individual in Schedule J columns (B)(i)-(iii) must equal the total reportable compensation amount (generally the Form W-2 Box 5 amount) for that person. The organization may report the 401(k) or 403(b) employee deferral in either column (B)(i) as base pay, or in column (B)(iii) as other reportable compensation. For instance, if an employee has Box 5 compensation of \$200,000, including \$5,000 of 401(k) employee deferrals, the organization may report \$200,000 in base pay, or \$195,000 in base pay and \$5,000 in other reportable compensation in Schedule J, column (B).

TIP: Certain pre-tax deductions from Box 5 compensation raise reporting issues not expressly addressed by the instructions. These include pre-tax deductions for certain health insurance premiums, the value of which is not included in Box 5. For example, an employee with base pay of \$200,000 before a pre-tax deduction of \$5,000 for health insurance premiums might have \$195,000 reported in Box 5 of the Form W-2. The organization should report \$195,000 in column (B)(i) of Schedule J, and \$5,000 in column (D).

13. How do we know whether the compensation we're paying to our officers and key employees is reasonable?

Reasonable compensation is the value that would ordinarily be paid for like services by like enterprises under like circumstances. Reasonableness is determined based on all the facts and circumstances. For more information on reasonable compensation, see Form 990 instructions, Appendix G, Section 4958 Excess Benefit Transactions, and Form 990-EZ instructions, Appendix E, Section 4958 Excess Benefit Transactions.

B. Questions for Political Organizations

1. What does a political organization report in Part VII of Form 990?

Internal Revenue Code section 527 does not require political organizations to be organized with boards of directors, officers and trustees, but if the political organization is organized in this way, it must provide the names, addresses, title, average hours worked and compensation of those officers, directors and trustees, key employees, highest compensated employees and independent contractors.

2. What is a related organization for purposes of reporting compensation paid by related organizations on Form 990?

A related organization is any organization that meets one of the following tests:

Fifty percent or more of the political organization's officers, directors, trustees or key employees are also officers, directors, trustees or key employees of the other organization.

The political organization appoints fifty percent or more of the other organization's officers, directors, trustees or key employees.

Fifty percent or more of the political organization's officers, directors, trustees or key employees are appointed by the other organization.