AUGUST 2007

ARTS Law Memo

News from the friendly IRS

The Internal Revenue Service has announced the next round of changes required by the Pension Protection Act of 2006: smaller nonprofits will be required to file Form 990-N starting in 2008, and organizations that fail to file for three consecutive years will lose their tax-exempt status.

Previously announced changes of interest to nonprofit arts organizations include required disclosure of Form 990-T, which reports unrelated business income tax; a new tax break for some IRA owners; and new donor record keeping requirements.

The IRS also has released a discussion draft of a redesigned Form 990. It is the first major overhaul of the form in 25 years.

This issue of *Arts Law Memo* summarizes these important changes. It also highlights the increase in arts giving and other trends as reported in *Giving USA 2007*.

Beginning in 2008, small tax-exempt organizations — those with gross receipts of $25,000 or less — will be required to file an annual electronic notice.

Information Returns

IRS Form 990 *Return of Organization Exempt From Income Tax* is an annual informational return submitted by tax-exempt organizations. A short version, Form 990-EZ, is used by organizations with gross receipts of less than $100,000 and total assets of less than $250,000. Private foundation file Form 990-PF.

Organizations that file these forms do not pay federal tax on income related to their exempt purposes and programs, although most private foundations pay an excise tax based on their investment income. A tax-exempt organization that fails to file the required return is subject to a penalty of $20 a day for each day they fail to comply.

For tax year 2004 (the most recent year for which complete data is available) the IRS received 364,601 Form 990s and 142,269 Forms 990-EZs, for a total of 506,870 returns.

These forms provide the public with financial information about tax-exempt organizations and are used by federal and state government agencies to ensure that organizations do not abuse their tax-exempt status.

Small Organizations Take Note

Beginning in 2008, small tax-exempt organizations — those with gross receipts of $25,000 or less — will be required to file Form 990-N.

Also known as the e-Postcard, the return must be filed electronically. There will be no paper form. The notice will require your organization to provide the following information:

- Organization's name
- Other names your organization uses
- Organization's mailing address
- Organization's Web site address
- Organization's employer identification number (EIN)
- Name and address of a principal officer of your organization
- Organization's annual tax period
- A statement that your organization's annual gross receipts are still normally $25,000 or less
- If applicable, notice that your organization is going out of business

Form 990-N will be due at the same time as a regular Form 990s and Form 990-EZs: The filing deadline is the 15th day of the 5th month after your fiscal year ends. So, if your fiscal year ends on December 31, your Form 990 is due on May 15 of the following year. If your fiscal year ends on June 30, the deadline is November 15.

The IRS will be mailing letters notifying small tax-exempt organizations that they will be required to file the e-Postcard.

If you believe the IRS may have an incorrect address for your organization,

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VLAA helps artists and arts organizations solve and avoid legal and accounting problems by:
- Making referrals to lawyers and accountants;
- Mediating arts-related disputes;
- Publishing Arts Law Memo and concise how-to guides;
- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Facilitating meetings;
- Conducting and disseminating research;
- Contributing articles to publications;
- Collaborating on arts advocacy initiatives; and
- Providing access to the national volunteer lawyers for the arts network.

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file Form 8822, *Change of Address*. You will need to complete Parts II and III. To download Form 8822, go to www.irs.gov and click on Forms and Publications.

The Pension Protection Act requires the IRS to revoke the tax-exempt status of any organization that fails to meet its annual filing requirement for three consecutive years.

For more information about the new electronic notice, visit www.irs.gov/charities.

Disclosing Unrelated Income

Under the Pension Protection Act, tax-exempt organizations are now required to publicly disclose their *Exempt Organization Business Income Tax Return*, Form 990-T.

The IRS defines unrelated business income as “income from a regularly-carried-on trade or business that is not substantially related to the organization’s exempt purpose.” (For more information on unrelated business income, visit the IRS’s audio-visual tutorial, www.stayexempt.org/course2brown/index.html.)

Until last summer, Form 990-T was considered a tax return and was not open to the public inspection rules covering applications for tax-exempt status and the main Form 990.

For more information, see *FAQs About the Exempt Organization Public Disclosure Requirements*, www.irs.gov/charities.

Draft Designed Form 990

In June, the IRS released for public comment a discussion draft of a redesigned Form 990. The proposed redesign does not yet affect the other forms in the 990 series.

Form 990 has not been revised since 1979. According to the IRS, the redesign is based on three guiding principles:

- Enhancing transparency to provide the IRS and the public with a realistic picture of the organization, along with a basis for comparison to other organizations.
- Promoting compliance by accurately reflecting the organization’s operations so the IRS may efficiently assess the risk of noncompliance, and
- Minimizing the burden on filing organizations.

The redesigned Form 990 consists of a 10-page core form. The form’s 15 schedules are designed to require reporting of information only from those organizations, such as hospitals, which conduct particular activities.

Among the highlights of the revised form are:

- A summary page providing the organization’s identifying information and a snapshot of the organization’s key financial, compensation, governance and operational information.
- A portion of the form requiring governance information such as whether the organization has whistleblower and record retention policies.
- Schedules that will focus reporting on certain areas of interest to the public and the IRS such as fund-raising, compensation, tax-exempt bonds and non-cash charitable contributions.

The IRS, which anticipates using the new form for the 2008 tax year (returns filed in 2009), is seeking feedback through mid-September.

Donor Recordkeeping & IRA Rollover

The Pension Protection Act of 2006 included a new tax break for some IRA owners and new record-keeping requirements for taxpayers claiming a deduction for cash donations.

Under the new law, a donor cannot claim a tax deduction for any contribution of cash, a check or other monetary gift made on or after January 1, 2007, unless the donor maintains a record of the contribution in the form of a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution and the amount of the contribution.

For guidance on acknowledging contributions, see Publication 1771, *Charitable Contributions Substantiation and Disclosure Requirements*. But please note that this version of the publication, which is dated July 2005, does not include the recent tax law change.

The IRS has updated Publication 561 *Determining the Value of Donated Property*. This publication is designed to help donors and appraisers determine the value of property (other than cash) that is given to tax-exempt organizations.

To encourage charitable giving, the Pension Protection Act included a temporary incentive for elderly donors. The Act allows individuals age 70½ and older to make charitable donations of up to $100,000 from Individual Retirement Accounts (IRAs) and Roth IRAs without having to count the distributions as taxable income, regardless of whether they itemize their deductions. That provision is set to expire in December.

As of May 2007, the National Committee on Planned Giving had tracked more than 3,719 individual distributions with a total value of more than $67 million. In addition to extending the incentive beyond 2007, the Public Good IRA Rollover Act of 2007, introduced by Sen. Byron Dorgan (D-ND) and Sen. Olympia Snowe (R-ME), and in the House by Rep. Earl Pomeroy (D-ND) and Rep. Wally Herger (R-CA), would expand the IRA charitable rollover.

Donors over age 70½ would be able to make unlimited direct transfers from IRA to qualified exempt charities. The new law also would include gifts made to donor-advised funds, supporting organizations and private foundations as well as to planned gifts that donors may make starting at age 59½.

For more information, including tools to help charities and donors, visit Independent Sector’s Web site (www.independentsector.org).

Charitable giving reaches $295 billion
arts experience biggest increase

Compared to other sectors such as education and human services, arts, culture and humanities experienced the biggest increase in charitable giving in 2006, according to *Giving USA 2007*, the yearbook of philanthropy published by the Giving USA Foundation. A 9.9 percent increase in donated dollars resulted in $12.51 billion in gifts to the arts. The arts sector received a 4.2 percent share of total giving in 2006, an increase from 4 percent in 2005 but down from a high of 5.6 percent in 1998.

Religious organizations continued to be the largest recipients of charitable gifts. Donors contributed $96.82 billion, or 32.8 percent of total giving, to their religious congregations. But the religious piece of the philanthropic pie has been shrinking; ten years ago is was 40 percent of the total, and two decade ago is was 53 percent.

Overall, U.S. charitable giving reached a new record in 2006, an estimated $295.02 billion. Donors gave an estimated $11.97 billion more than in 2005, a 4.2 percent increase (1.0 percent adjusted for inflation) compared to the revised estimate for 2005 of $283.05 billion.

The data reveal several trends. First, despite concerns about a decrease in donations in 2006 due to the outpouring of disaster relief in 2005, giving held up well. If disaster gifts are excluded from the 2005 total, giving in 2006 looks even stronger, rising 6.6 percent (3.2 percent after adjusting for inflation).

Second, mega-gifts, such as Warren Buffett's $30 billion pledge to the Bill & Melinda Gates Foundation, made news in 2006, but these gifts of $1 billion or more still are a small piece (1.3 percent) of the total giving pie.

Giving by individuals, always the largest single source of donations, rose by 4.4 percent. (1.2 percent adjusted for inflation) to an estimated $222.89 billion and accounted for 75.6 percent of all estimated giving in 2006. According to *Giving USA*, about 65 percent of households with incomes lower than $100,000 gave to charity. That is higher than the percentage people who vote or read a Sunday newspaper.

Charitable bequests are estimated to be $22.91 billion in 2006, a 2.1 percent drop from the revised value for 2005, which is based on IRS records.

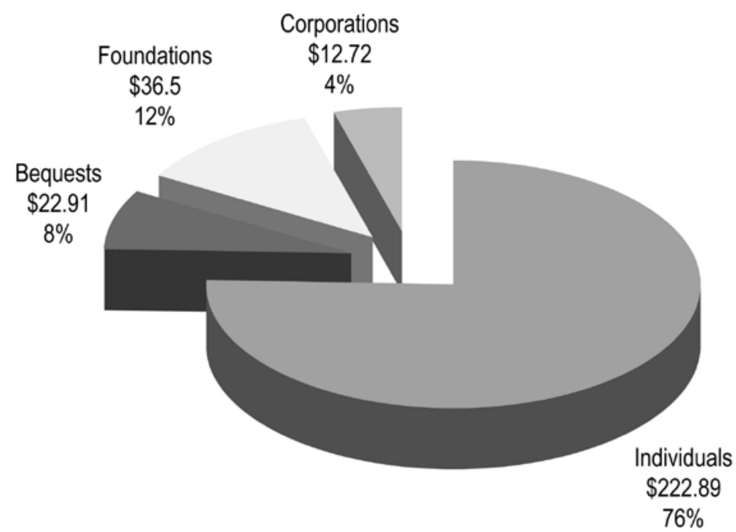
Foundation grantmaking, as recorded by the Foundation Center and reported in *Giving USA*, rose 12.6 percent to $36.5 billion. The increase is attributed to the growth in the number of foundations and the bullish stock market. Foundations make grants based in part on the value of their assets, and when asset values rise quickly, grantmaking increases.

Foundation giving accounts for 12.4 percent of total estimated charitable giving in 2006. A decade ago foundations represented 8.5 percent of philanthropic dollars.

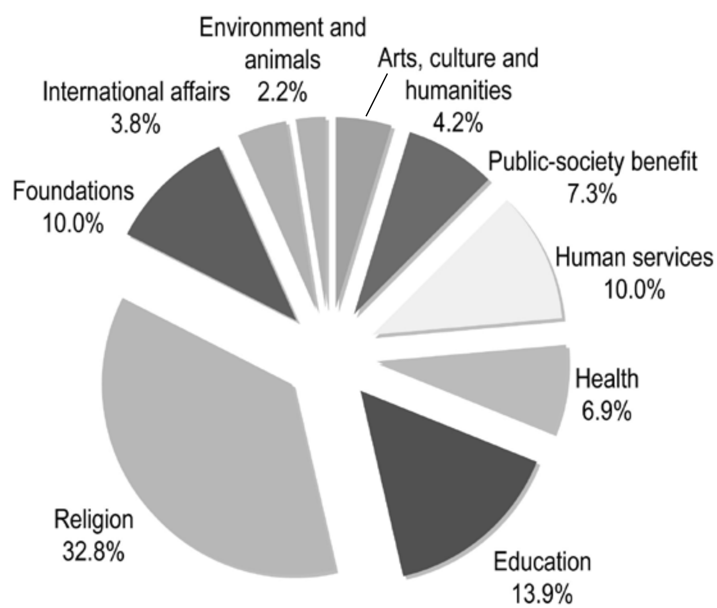
Donations by corporations and corporate foundations are estimated to be $12.72 billion in 2006. This is a decline of 7.6 percent that reflects the extraordinary gifts in 2005 for disaster relief as well as a slow-down in the rate of growth for non-disaster-related corporate giving.

Giving USA 2007 (with data for 2006) sells for $75. The book along with a subscription to *Spotlight* (a quarterly newsletter) is available for $130. Both may be ordered by calling 847/375-4709 or by downloading an order form from www.givingusa.org.

Contributions by Source (in billions)



Contributions by Type of Recipient



IRS jumps on the best practices bandwagon

In February, the IRS released a *Good Governance Practices Discussion Draft* for charitable organizations. According to the IRS, "the informal draft reflects various ideas that have been advanced by others both within and outside the exempt sector who have studied nonprofit governance." Examples include the Better Business Bureau's Wise Giving Alliance *Standards for Charity Accountability*, Independent Sector's *Checklist for Accountability,* the Donors Forum's *Illinois Nonprofit Principles and Best Practices* (see *Arts Law Memo*, Standards Mania, May 2006).

Governance has historically been considered a matter of state law. While acknowledging that it has no authority to impose its recommendations on tax-exempt organizations, the IRS's position is that organizations that adopt these practices will be more likely to succeed in achieving their stated exempt purposes and in attracting public support.

Included in the draft are nine recommendations to help ensure that board members understand their roles and responsibilities and actively promote good governance practices:

1. **Mission Statement.** Have a clearly articulated mission statement.

2. **Code of Ethics and Whistleblower Policy.** Adopt and regularly evaluate a code of ethics that communicates a strong culture of legal compliance and ethical integrity. As required by Sarbanes-Oxley, adopt a whistleblower policy.

3. **Due Diligence and the Duty of Care.** Put in place policies and procedures to help board members meet their duty of care. Board members should have full and accurate information that allows them to make informed decisions.

4. **Duty of Loyalty.** Make sure directors understand their duty of loyalty. Adopt and regularly review a conflict of interest policy.

5. **Transparency.** Adopt procedures to ensure that organization makes full and accurate information about its mission, activities and finances (including IRS Form 990) available to the public.

6. **Fund Raising Policies.** Ensure that fund raising materials are accurate, truthful and candid, that fund raising activities comply with federal and state law and that fund raising costs are kept at a reasonable level.

7. **Finances.** Ensure that financial resources are being used to further the organization's charitable purposes by regularly receiving and reading financial statements. For large organizations, require an independent auditor and seriously consider establishing an audit committee and changing auditors every five years.

8. **Compensation Practices.** Pay no more than reasonable compensation for services rendered. Avoid paying board members any compensation other than reimbursement for expenses.

9. **Document Retention Policy.** As required by Sarbanes Oxley, adopt a document retention policy that includes guidelines for handling electronic files.

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