

In Brief

January 2010

EDUCATIONAL FOUNDATION UPDATE

There have been many recent changes to laws affecting 501(c)(3) foundations. Below is a summary of the changes that may affect the foundation supporting your institution.

501(c)(3) FOUNDATIONS MUST TIMELY FILE ANNUAL INFORMATION FORM 990

On January 21, 2010, the Internal Revenue Service (IRS) issued a Notice reminding tax exempt organizations of their obligation to timely file their Annual Information Form 990. Any organization that has not filed the required form in the last three years will have its tax-exempt status revoked in 2010, as provided under the Pension Protection Act of 2006. Any tax exempt organization that loses its exemption will have to reapply with the IRS to regain tax-exempt status and any income received between the revocation date and the renewed exemption may be taxable, according to the IRS.

The required Annual Information Form 990 series, was recently changed by the IRS (see below). Form 990 returns and e-postcards are due by the 15th day of the 5th month after an organization's tax year ends.

For questions related to completing Form 990 or meeting your Foundation's deadline, please contact Nanci N. Rogers or Camille Cribaro-Mello at the firm's Chicago office.

IRS PROVIDES GUIDANCE AND TRAINING MATERIALS FOR NEW FORM 990 AND 990-EZ REPORTING

Recently, the IRS redesigned Form 990 to be filed by charitable organizations. The redesigned form applies to the 2008 tax year and returns filed in 2009 or 2010.

This information return serves as the primary tax compliance tool for tax-exempt organizations and is relied upon by the State for support of state income tax exemption. In revising the Form 990, the IRS focused on three guiding principles: enhancing transparency, promoting tax compliance, and minimizing the burden on the filing organization.

Phased-in Filing Requirements

To provide smaller organizations additional time to adapt to the new form, the IRS is phasing in, over a three-year period, the requirement to file the new form. For the 2008 tax year:

- Organizations must file the new 990 for the 2008 tax year if they have either gross receipts of \$1 million or more, or total assets of \$2.5 million or more;
- Organizations can choose Form 990 or 990-EZ if they have gross receipts greater than \$25,000 and less than \$1 million and assets less than \$2.5 million;
- Very small tax-exempt organizations – those with gross receipts of \$25,000 or less – should submit a new electronic form called the 990-N or e-Postcard.

New Governance Section

The new form includes a section on governance, consisting of three parts – composition of the organization's governing body, its governance and management policies and its disclosure practices. The IRS intends this section to help determine

whether the organization has policies in place to assist with compliance.

New Reporting of Compensation and Insider Transactions

The new Form 990 significantly revises the reporting of executive compensation and transactions with interested persons. All organizations still must list their officers, directors, trustees, and key employees (whether compensated or not) and report compensation paid by the organization and related organizations to each person listed. Additionally, compensation paid to the organization's five highest compensated individuals, and five highest paid independent contractors must be reported. The reporting threshold for employees and independent contractors was raised from \$50,000 to \$100,000 and everything above that threshold must now be reported. Additionally, a new Schedule L must be used to report excess benefit transactions, loans, grants and other financial assistance, and business transactions involving interested persons.

New Schedules

The Form 990 now has 16 schedules that may apply to a reporting organization. An organization should only complete the schedules that apply to it. To assist in discerning the new schedules and other changes with the new Form 990, the IRS has made many training materials available on-line. In addition to new instructions, the IRS provides sample, completed Form 990, case studies and videos from their web site at:

<http://www.irs.gov/charities/article/0,,id=201398,00.html>.

Next Steps

If you have not already done so, you should begin reviewing the new Form 990 and instructions and consider the following steps:

- Determine whether you may file Form 990-EZ for 2008;
- Identify any related organizations required to be listed on Schedule R;

- Identify the officers, directors, trustees, and potential key employees and top 5 highest compensated employees;
- Review the new governance questions, which should be answered based on policies and practices in place during the 2008 tax year; and
- Identify the schedules the organization will be required to complete

In addition to the IRS web site, other helpful materials may be found at www.stayexempt.org.

ILLINOIS' GENERAL NOT FOR PROFIT CORPORATION ACT IS AMENDED

Effective January 1, 2010, the General Not For Profit Corporation Act, (805 ILCS 105, et seq.) is amended and these changes may require revisions to the Foundation's by-laws.

Informal Action by Members Entitled to Vote

Previously, informal action could be taken without a meeting and without a vote, if all of the members entitled to vote consented in writing. Under the amended Act, informal action now requires that the members entitled to vote must vote, however they may do so without a meeting. The amended Act provides that the vote may be taken by e-mail, or other electronic means and requires that a quorum of members cast a vote. Voting must remain open for five (5) days from the date the ballot is delivered, however in the case of the removal of one or more directors, a merger, consolidation, dissolution or sale, lease or exchange of assets, the voting must remain open for twenty (20) days. (805 ILCS 105/107.10). We recommend that the Foundation's By-Laws be amended to reflect this change.

Proxies

Unless otherwise prohibited by the Foundation's Articles of Incorporation or By-Laws, the election of directors, officers, or representatives by members may be conducted by mail, email, or any other electronic means. (805 ILCS 105/107.50). If the Foundation is interested in this flexibility, we recommend that the Foundation's By-Laws be amended.

Access to Books and Records – Voting members have the right to examine, in person or by agent, the corporation’s records of account and minutes, provided there is a proper purpose for the examination. In order to exercise this right, the voting member must make a written demand upon the corporation, stating with particularity the records to be examined and the purpose of the examination. If the corporation refuses to allow the voting member access to the records, the voting member may file suit in Circuit Court to compel the examination. (805 ILCS 105/107.75).

Directors’ Terms

Any action to amend the corporation’s By-Laws to decrease the number of directors, eliminate the position of a director elected or appointed by persons other than the members, or shorten the terms of incumbent directors must be approved by the party with authority to elect or appoint such directors. (805 ILCS 105/108.10(d)). We recommend that the Foundation’s By-Laws be amended to reflect this change.

Illinois Adopts the Uniform Prudent Management of Institutional Funds Act

On June 30, 2009, Governor Quinn signed the Uniform Prudent Management of Institutional Funds Act (P.A. 96-0029), which replaces the Uniform Management of Institutional Funds Act. Key differences in the new Act include the elimination of the “historic dollar value” rule with respect to endowment fund spending; new prudence standards for the management and investment of charitable funds; and amended provisions regarding the release and modification of restrictions on charitable funds. The new spending rules apply only to endowment funds, which are defined as institutional funds that are not wholly expendable on a current basis because of a donor restriction in the gift instrument. These provisions do not apply to funds that are restricted only by a board of directors or to funds only informally referred to as “endowments.” Charitable organizations should determine whether they have any funds subject to this new Act.

Under the new Act, charitable organizations will have more flexibility in spending. Many endowment agreements provide that only the “income” from the gift could be spent, while the “principal” should be retained. Additionally, under the old law,

endowment funds were restricted in that they could not spend an amount that would cause the fund balance to be lower than the amount of the original gift (“historic dollar value”). Past interpretation of such provisions required that only dividends, interest, rent or royalties could be spent, while the principal amount, and any appreciation, could not. While the intentions of a donor expressed in a gift instrument will always govern the spending from an endowment fund, use of the terms “income” or “principal” will not be interpreted to mean that the donor intended to limit the spending in any particular manner. Unless specifically directed to the contrary, a charitable organization may spend so much of an endowment fund as an ordinarily prudent person in like position would spend for the uses, benefits, purposes and duration for which the endowment fund established. Under the new law, there is no longer a distinction between income and principal, nor is there a need to track historic dollar values. So long as the spending decisions are prudent, the charitable organization may spend any amount from an endowment fund. The factors that a charitable organization should consider in making decisions about whether an expenditure from an endowment fund is prudent include:

- The duration and preservation of the endowment fund;
- The purposes of the charitable organization and the endowment fund;
- General economic conditions;
- The effects of inflation or deflation;
- The expected total return from investments;
- Other resources of the charitable organization; and
- The investment policy of the charitable organization.

The governing board of the charitable organization should weigh all of these factors when making decisions and setting policy regarding endowment spending.

Similarly, the Act sets forth more specific standards governing the investment of charitable funds.

Persons responsible for managing and investing charitable organization funds must consider the charitable purpose of the organization and the purposes of the fund, and must act in good faith and with the care an ordinarily prudent person in like position would exercise under similar circumstances.

The factors to be considered include:

- The general economic conditions;
- The possible effects of inflation and deflation;
- The tax consequences of an investment strategy;
- The role of each investment within the portfolio as a whole;
- The expected total return from income and appreciation of the investments;
- The other resources of the charitable organization and its needs; and
- An asset's special relationship or value to the charitable purpose.

As part of this prudence standard, the charitable organization is also required to diversify the investments of its funds, unless the organization reasonably determines that special circumstances favor no diversification.

The new Act also updates the method for modifying donor restrictions on funds that may be used.

Now, in addition to requesting the donor to modify or release a restriction, a charitable organization may request a court to modify or release a donor restriction when it is impracticable, wasteful, impairs management or investment of the fund, or due to unanticipated changed circumstances where a modification will further the purpose of the fund. A court may also modify the charitable purposes contained in the gift instrument if the original purposes become unlawful, impracticable, impossible to achieve, or wasteful. Without court involvement, a charitable organization may also request the Illinois Attorney General to modify or release a restriction where (1) a restriction is unlawful, impracticable, impossible to achieve, or wasteful or (2) the fund subject to restriction has a total value of less than \$50,000 and has existed for more than 20 years, and the funds are used in a manner consistent with the charitable purposes expressed in the gift instrument.

Any questions regarding the contents of this InBrief may be directed to Nanci N. Rogers or Camille Cribaro-Mello of the firm's Chicago office.

This InBrief was prepared by Camille Cribaro-Mello, an attorney in RSNLT's Chicago Office.

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