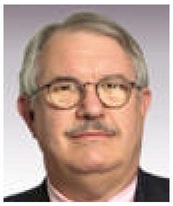
PJ PHILANTHROPY JOURNAL

September 4, 2009

Understanding bonds and the new Form 990



by William H. McBride

The revised IRS Form 990, specifically the new Schedule K, requires increased reporting from nonprofits regarding their outstanding bond issues.

As they review their new Form 990 reporting responsibilities, nonprofits should be aware that the level of detail required by Schedule K could easily be used to identify audit targets.

In light of this, they should assess carefully the data they provide in Schedule K for potential audit liability.

Nonprofits must file a Form 990 unless they either qualify for the small-organization exception or are an otherwise exempt organization, such as religious organizations, political organizations or governmental units or affiliates.

Schedule K only requires information about bonds issued after 2002. Nonprofits should be aware, however, that certain changes to bonds issued before 2002, such as mode changes, liquidity replacements or document amendments, may trigger a "reissuance" and make them subject to Schedule K disclosure.

Care should also be taken to clearly define the purpose of each bond, as well as the "bond-financed property."

From 2009 on, Schedule K will include detailed questions on the use of proceeds and private business use with respect to bond-financed property, and it would be wise to prepare for those questions now.

In cases where two or more nonprofits are beneficiaries of the same bond, each must file its own Schedule K. Coordination between these nonprofits is key to ensure there are no conflicts in the answers they provide.

There are three parts to Schedule K, though only the first will be mandatory for fiscal year 2008. However, great care should be taken even this year as the information provided in Part I will be used in future filings.

The basic requirements of each part are:

Part I: Identify each qualifying outstanding bond issue. Carefully answer questions about the purpose of an issue, as well as whether the nonprofit was an issuer or borrower.

Part II: Itemize the use of proceeds per issue, specifically: (1) dollar total; (2) gross proceeds and reserve funds; (3) refunding or defeasance escrows; (4) unspent proceeds; (5) issuance costs; (6) working capital expenditures; and (7) capital expenditures.

Part III: Provide details regarding ownership of the financed property, lease arrangements, management contracts, research agreements, percentage of private use, and related information on an issue-by-issue basis. Answers should be consistent with statements from an organization's tax or bond counsel at the time of issuance, unless specifically advised otherwise by counsel. The importance of consistent legal determination is underscored by questions in Part II regarding whether the nonprofit routinely engages a bond counsel and whether management practices and procedures regarding post-issuance compliance have been adopted.

The new Form 990 and Schedule K represent a detailed information gathering effort by the IRS that will necessitate the expenditure of significant amounts of time by any reporting nonprofit entity with outstanding bond issues.

Nonprofits now more than ever should identify separate issues for reporting very carefully. In addition, the purpose of each issue and the particular bond-financed property associated with each issue should be isolated for recordkeeping purposes.

As a result of the Schedule K requirements, issuance dates now are very important, as are conditions that may create a "reissuance" that will require information on an issue to be included in the Form 990 filing.

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