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To: Corporate Governance Task Force
Joint endeavor of HMOs and Health Plans; Hospitals and Health Systems; In-House Counsel; Tax and Finance; and Teaching Hospitals and Academic Medical Centers Practice Groups

From: Corporate Governance Task Force Leadership*

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Corporate Governance Update **IRS Commissioner Provides New Guidance on "EO" Governance** By Michael W. Peregrine and Elizabeth M. Mills**

Last week at the Georgetown Law tax law conference, IRS Commissioner (Tax Exempt and Government Entities), Steven T. Miller gave two separate, important, and thoughtful presentations in which he (a) confirmed, with what we think greater clarity than previously had been the case, the jurisdictional basis for the IRS' continuing interest in exempt organization governance, (b) identified steps the IRS has taken in this regard, and (c) highlighted areas of IRS governance focus in the near term.

Commissioner Miller's comments emphasized the following:

- **Implicit Jurisdiction.** The IRS interest in exempt organization governance is based on what Commissioner Miller refers to as *implicit jurisdiction*; while the Internal Revenue Code does not expressly provide a corporate governance standard, it is nevertheless a subject in which the IRS seeks involvement to assure not only the integrity and compliance of the tax exempt sector, but also the public's confidence therein. More specifically, the quality of governance impacts all aspects of the IRS' oversight over exempt organizations—furtherance of exempt purposes, private inurement, excess private benefit, reasonable compensation, informed and fair decision making regarding investments and fundraising practices, and self-dealing.
- **Areas of Focus.** Governance-related emphasis in the near term will primarily be on three issues. The first topic is board composition; *i.e.*, assuring that an active, independent, and engaged board of directors is overseeing the organization. The extent of independence of the board will continue to be an area of focus. The second topic is whether the organization has internal financial procedures and controls that will safeguard assets and assure their use consistent with charitable purposes. These procedures may include oversight of investment in sophisticated financial products, oversight of investments in joint ventures with for-profit partners, and investments in for-profit subsidiaries. The third topic is whether the organization has a governance structure that assures accountability to persons other than officers and directors, and review of major decisions for consistency of the expenditure or activity for appropriate purposes.
- **Education, Examination, and Enforcement.** The IRS will continue its substantial efforts to educate the sector on

governance-related topics, through multiple avenues. Transparency in reporting on the Form 990 will be emphasized, with the possibility for new penalties for failure to answer the governance-related (and other) questions. From an examinations perspective, questions about governance and financial practices will be asked at the commencement of the examination, and consideration is being given to the creation of a new post-exam checklist regarding corporate governance.

- **Efficiency and Effectiveness.** The IRS can also be expected to exercise its "implicit jurisdiction" to examine fundraising efficiency and compensation. To do so, the IRS may use its long-articulated "commensurate test"—*i.e.*, that to be exempt, an organization should demonstrate its primary charitable purpose by carrying on a charitable program commensurate with its financial resources—more broadly in the exempt organization sector. The purpose of this exercise is to "create and enforce a standard to ensure that organizations spend in line with their resources."

Commissioner Miller's thoughtful comments reflect an Internal Revenue Service that is optimistic about the overall direction of the tax exempt sector, yet committed to an active role in support of effective governance practices by the sector. The issues and themes presented by Commissioner Miller could thus be helpful in explaining to client executive and board leadership why the IRS is so interested in corporate governance, and the related importance of effective governance and compliance policies. They may also be useful when responding to recommendations of non-lawyer governance consultants which involve board structures potentially in conflict with tax and corporate law.

Commissioner Miller's presentations can be accessed on the [IRS website](#).

***AHLA wishes to thank Michael W. Peregrine, Esquire, and Elizabeth M. Mills, Esquire (McDermott Will & Emery LLP, Chicago, IL) for authoring this update.*

*Corporate Governance Task Force Leadership for FY 2008

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Member benefit educational opportunity:

[Teleconference](#) on new instructions for the New 990 (May 6, 2008).

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