VENABLE LLP

Articles

October 2013

The Evolving Schedule K to IRS Form 990: Supplemental Information on Tax-Exempt Bonds

AUTHORS

Walter R. Calvert

Tammara F. Langlieb

DOWNLOADABLE FILES

- The Evolving Schedule K to IRS Form 990: Supplemental Information on Tax-Exempt Bonds

RELATED PRACTICES

Tax-Exempt Organizations

RELATED INDUSTRIES

Nonprofit Organizations and Associations

ARCHIVES

2013 2009 2005
2012 2008 2004
2011 2007 2003
2010 2006

Hints for the Wise and Traps for the Unwary

A 501(c)(3) organization with outstanding tax-exempt debt generally is required to file Schedule K "Supplemental Information on Tax-Exempt Bonds" with its annual IRS Form 990. This article seeks to assist the preparer of Schedule K by focusing on questions that are confusing or that could trigger an audit if answered inappropriately or without complete explanations. We will not address Part I of Schedule K which relates to basic information about bond issues or every line on the remaining parts of Schedule K, but instead will provide explanations on tricky topics and suggest best practices for topics that most frequently raise questions or concerns.

Background

In 2007, the IRS revamped the Form 990 and introduced Schedule K. Schedule K has been a work in process ever since, having been modified several times in the intervening years. Currently, Schedule K is divided into six sections. Part I focuses on basic information about the bond issues, Part II analyzes the use of proceeds, Part III reviews the amount of the private business use, Part IV discusses arbitrage, Part V inquires about the conduit borrower's remediation actions and Part VI is space for the conduit borrower to provide additional information. The regular filing deadline for a 501(c)(3) organization with a tax year ending June 30 is the immediately following November 15th.

Schedule K provides an excellent audit tool for the IRS to track outstanding tax-exempt bonds and monitor their compliance status based on self-reporting by the conduit borrowers. The two primary areas of potential misuse of tax-exempt bond proceeds covered in some detail by Schedule K are (i) arbitrage -- the potentially abusive investment of bond proceeds at a yield greater than the bond yield, and (ii) private business use ("PBU") -- the use of bond proceeds or bond-financed facilities by other private businesses or in furtherance of unrelated trade or business activity in the case of 501(c)(3) organizations.

Part I: Rules to Prepare by

Three "golden rules" are worth remembering and applying when completing Schedule K:

1. Get It Right the First Time

Schedule K filings form a database for a particular bond issue from year to year, so consistency is important in preparing the Schedule. For the first year of filing for a particular bond issue, extra care should be taken to ensure that the correct baseline information is entered, as much of it will be carried forward from year to year and/or form the basis for updating in the following years.

2. Remember to Review Previous Bond Information

To complete the Schedule K, review the bond transcript, your own records as to uses of proceeds and uses of bond-financed facilities, and any records of trustees or other third parties as to the investment and disbursement of bond proceeds. Use the Form 8038 filed by the issuer with the IRS as the source to complete the general information needed in Schedule K, Part I, "Bond Issues."

3. Check Your Compliance Procedures

Parts II, III, IV, and V of Schedule K each have a separate question involving the same theme: Has the 501(c)(3) organization adopted procedures for monitoring the bond(s) post-closing to ensure compliance with federal income tax law and is the organization maintaining the records necessary to support such compliance? The sheer number of repetitious questions on this theme is designed to convey a warning—if 501(c)(3) organizations do not adopt compliance procedures, there is a good chance that the IRS will audit their bonds.

Certain lines on Schedule K ask questions that merit some explanation to yield good answers. Below, we discuss the lines that we encounter as most frequently raising questions or generating issues in the answers filers provide.

Click here to view the full text of this article.