

# The Governance Institute

## IRS Definition of an “Independent Person”

There is no one-size-fits-all definition of an “independent person” of a non-profit corporation, for the purposes of determining director independence. Some state non-profit codes (e.g., California) have adopted a specific definition. The IRS adopts a unique and multi-step definition of an “independent person” for Form 990 reporting purposes. Healthcare corporations should consult their tax counsel as to the application of this definition (contained in the Index to the Form 990) for purposes of applying it to specific relationships.

A member of the governing body is considered “independent” only if all four of the following circumstances applied at all times during the organization’s tax year:

1. The member wasn’t compensated as an officer or other employee of the organization or of a related organization (see the Instructions for Schedule R (Form 990)) except as provided in the religious exception discussed below. Nor was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A.
2. The member didn’t receive total compensation exceeding \$10,000 during the organization’s tax year (including a short year, regardless of whether such compensation is reported in Part VII) from the organization and related organizations as an independent contractor, other than reasonable compensation for services provided in the capacity as a member of the governing body. For example, a person who receives reasonable expense reimbursements and reasonable compensation as a director of the organization doesn’t cease to be independent merely because he or she also receives payments of \$7,500 from the organization for other arrangements.
3. Neither the member, nor any family member of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization’s tax year.
4. Neither the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization.

## Determining Whether a Conflict of Interest Exists

A financial interest is not necessarily a conflict of interest. A person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

After disclosure of the financial interest and all material facts, and after any discussion with the independent person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.