

COMPENSATION STRATEGIES

Get Your Comp Package in Order

With Wall Street bonuses such a hot button issue, you can bet that nonprofit executive compensation will remain a touchy subject with the public as well as state and federal regulators. At the same time, nonprofit boards are realizing that they have to compete for top talent from the for-profit world — compete with for-profit salaries and benefits.

THE LAY OF THE LAND

While Wall Street-style perks and bonuses are out of the question, nonprofits are permitted to offer competitive compensation packages. In fact, the Internal Revenue Service (IRS) allows the use of compensation data from for-profit companies when calculating compensation for nonprofit executives.

The key is to follow the rules — scrupulously — to avoid being caught up in the web of intermediate sanctions. These are special punitive taxes created by Congress on transactions involving excessive benefits. An executive's compensation is not generally considered to be excessive if it is consistent with the compensation paid to executives with comparable jobs in comparable organizations. Further, the IRS generally presumes that the compensation is reasonable if *each* of the following conditions are met:

- Disinterested person(s) made the compensation decision.
- Appropriate data was used in making the compensation decision.
- The decision was documented.

It's important to note that the nonprofit organization has the burden to prove its compensation is reasonable.

SO, WHAT IS "REASONABLE"?

Reasonable compensation is defined by Reg. 1.162-7(b)(3) as the amount that would ordinarily be paid for like services by like organizations in like circumstances. Here, all forms of compensation — not just salary or wages — must be included in the analysis. Certainly, there are legitimate charitable organizations with executives whose \$250,000 salaries are deemed "reasonable." Yet, at the other extreme, even a salary of just \$10,000 could be deemed "unreasonable" based on the organization's total budget. Bottom line: Nonprofits are allowed to offer substantial compensation packages — but they'd better be prepared to defend them.

YOU WILL BE ASKED

Form 990, Part VII, asks for very specific information about compensation of Officers, Directors, Trustees, Key Employees and Highest Compensated Employees. Independent contractors that received more than \$100,000 of compensation from the organization must also be listed.

If compensation is too high relative to the job performed, the executive must reimburse the "excess benefit" and is subject to a penalty equal to 25 percent of the excess benefit as well as excise penalties that may be in excess of 200 percent of the benefit received.

The IRS may also impose an excise tax of up to \$10,000 on each member of the decision-making body that authorized the compensation. These penalties are commonly known as "intermediate sanctions," as they fall short of revoking the organization's nonprofit status.

Use appropriate data. Use data for comparable positions in comparable organizations to determine compensation for executives. This can be accomplished by any of the following:

- Researching compensation paid by similar organizations.
- Using a current compensation survey compiled by an independent company.
- Collecting actual written offers from similar organizations.

Document everything. It's critical to document the method used to determine salary packages. The documentation must contain the compensation terms for the executive, the date of the approval, person(s) approving the compensation, the data relied upon for the decision, and any actions by an interested member of the decision-making body.

Keep it arms-length. The individuals who decide the executive's compensation must not have a personal interest in the compensation arrangement. Here, appointing or authorizing a committee to evaluate compensation may be wise. Where you get in trouble is when those voting on the package are related to the executive — by blood, marriage or outside business.

CREATE AN EFFECTIVE COMPENSATION PACKAGE

Fishing in the same talent pool as for-profit businesses, nonprofits have had to adopt executive compensation programs that take their cue from the for-profit world, including the use of performance-based incentives, bonuses and various revenue-sharing strategies. Today, an effective compensation package typically includes the following:

- **Base salary:** A competitive base salary that is commensurate with the executive's experience and based on the market value of that position.
- **Short-term incentives and bonuses:** Performance motivators that provide a clear link between performance and rewards.
- **Longer-term incentives:** Some form of deferred compensation, such as a Supplemental Executive Retirement Program (SERP) to reward long-service top executives.
- **Benefits:** Generous benefits, such as medical and paid time off, which may compensate for less-than-generous cash compensation.
- **Employment and change of control agreements:** Especially where a sought-after executive is reluctant to join an unfamiliar organization without the protections of a contract.

HERE TO STAY

Scrutiny of executive compensation is not going away anytime soon. In fact, it is only likely to increase. In order to protect your organization and its staff, make sure your board of directors undergoes a careful process to arrive at appropriate executive salaries. **In critical areas of compensation, our experienced professionals can provide expert guidance.**

For sources of salary data, please visit www.bobermarkey.com/nonprofit_advisor/nonprofit_advisor_summer_10

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