

# Executive Compensation and the IRS: *What best practices should you follow?*

NYSAE

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# “Intermediate Sanctions” Legislation

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## Section 4958 of the Internal Revenue Code:

- Addresses “excess benefit transactions” for non-profit and association executives in 501(c)3’s and 501(c) 4’s
- Requires reporting of compensation to officers and key executives known as “disqualified persons”
- Establishes “intermediate sanctions” penalties for excessive compensation
- Provides guidelines for “rebuttable presumption” defense
  - Board approves transaction in advance
  - Board relies on appropriate data with respect to comparability
  - Board documents basis for decision
  - Board relies on reasoned opinion of professionals

# Why a New 990?

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- Last redesigned in 1979 – **before** Intermediate Sanctions legislation
- Intended to:
  - Promote transparency
  - Assure compliance
  - Strengthen governance

# How New 990 Promotes Compliance

- Verifies processes are in place to assure regular review of compensation of CEO, officers and key employees
- Establishes steps to be included in compensation review process
- Requires reporting of compensation for:
  - Directors, officers and trustees
  - All **key employees** (up to 20) earning more than \$150,000 in reportable compensation
  - Top five highest paid employees receiving more than \$100,000
  - Former officers, key employees or highest-compensated employees who received more than \$100,000 in current tax year
  - Former directors and trustees who received more than \$10,000

# Sections of 990 Affecting Comp Practices

- Part VI – Governance, Management, and Disclosure
  - Section A. Governing Body and Management
    - 1b. # of voting members that are “independent”
    - 8 a and b. “Contemporaneous” documentation by governing body and “each committee with authority to act on behalf of the governing body”
  - Section B. Policies
    - 15. Process for determining compensation including review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision
- Part VII – Compensation Reporting
  - Section A – aggregates compensation received from the organization and related organizations
- Schedule J
  - Part II – More detailed breakdown of elements of compensation and reporting of compensation from prior filing.

# “Independent” Members

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- Governing Board - No conflicts of interest
  - Family Relationship
  - Business Relationship
  
- Compensation Committee - “Arm’s Length” Relationship
  - No family members
  - No persons who have a material financial interest affected by the decision
  - No persons in an employment relationship subject to direction or control of the disqualified person
  - No persons who receive compensation or other payment subject to approval of the disqualified person
  - No persons who have a reciprocal arrangement with the disqualified person

# “Comparability Data”

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- Benchmarking of executive positions to determine their comparability with market norms to substantiate “reasonableness”
- Verify role, responsibilities and qualifications of executive relative to market-comparable positions
- Market “norms” established on basis of
  - Geographic location
  - Organization type
  - Revenue size (1/2x to 2x)
- Data sources
  - Published salary surveys
  - IRS Forms 990 for peers
  - Consultant client database

# Total Compensation Comparison

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- IS regulations require look at all elements of compensation:
  - Base salary
  - Incentive or bonus pay
  - Standard ERISA-qualified health/welfare plans
  - Standard ERISA-qualified retirement plan(s)
  - Non-qualified supplemental plans
  - Taxable allowances
    - Non-taxable allowances reportable if they exceed \$10,000
  - Other benefits and perquisites
- Statutory benefits **not** reportable

# “Contemporaneous” Substantiation

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- Actions taken by the later of next meeting or 60 days.
- Provide summary of discussion with reference to materials on which decisions are based. If necessary, append copies of materials.
- Include sufficient information to allow Board to make informed decision consistent with its role as “organizational manager”.

# Why a Separate Compensation Committee?

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- Specific responsibility for safeguarding the organization in relation to compensation-related issues
- Smaller subset of board or Executive Committee eases scheduling and promotes focused discussion

# Compensation Committee:

## *Typical Responsibilities*

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- Establish the overall compensation philosophy for the organization
  - Relation of base salaries and total compensation to market
  - Components of total compensation (benefits, perquisites, etc.)
  - Criteria for market comparisons (organization type, budget, location)
- Establish organizational and individual performance goals and measures for the chief executive officer.
- Review the performance of the chief executive officer and recommend any compensation changes.
- Oversee all aspects of compensation provided to other executives to ensure compliance with intermediate sanctions provisions of the Internal Revenue Code.
- Prepare regular reports disclosing Committee actions and recommendations to the full Board of Directors.

# Questions?

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- For further information, please contact:

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