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Compensation: You Cannot Avoid the Rules, but You Can Avoid the Questions

Does this sound familiar…your organization's Form 990 is drafted and reviewed, and then the questions start (again!) Why do we need to report compensation? What is included in this compensation amount? Who will have access to that information? The questions come from Board members, executives and key employees who fall under the requirements of the Internal Revenue Service (IRS) reporting.

This spring, Johnson Lambert presented a webinar on not-for-profit executive compensation that reviewed best practices in the industry and a review of the IRS oversight. Some of the highlights to help ensure your organization is compliant and prepared to address these questions include:

- Developing oversight and responsibility with a compensation committee
- Using comparability data from third-party resources to set compensation
- Establishing a written contract for key executives
- Supporting your rebuttable presumption of reasonableness

A rebuttable presumption of reasonableness is a term frequently used when considering IRS requirements. The goal of this presumption is to ensure you've supported the reasonableness of the terms of compensation including the process used, board of directors' approval and any conflicts of interest. Documenting the process and key contract terms in writing not only protects your organization but also provides protection for the individual and avoids potential future conflict.

Given compensation of key executives and employees is included in IRS Form 990, Part VII, the scrutiny and review of compensation paid by not-for-profit organizations continues to grab headlines and be a key issue for board members and executives. It is important to understand the required employees and compensation that may fall under reportable compensation requirements. We recommend reminding your employees included in the reporting requirements of the information disclosed and ensuring these amounts are appropriately supported and reasonable.


Sarah McConnell, CPA

The Tax Reform Act of 2014 addresses employee compensation under Sec. 3803, Excessive Employee Renumeration. While the tax act is not likely to be voted on this year, the possible changes could affect your organization. Under current law there is no limitation on "deductibility" of executive compensation; however, the proposed legislation would subject tax-exempt organizations to a 25% excise tax on compensation in excess of $1,000,000 paid to its five highest paid employees for the tax year. The $1 million limit is not an aggregation of employees' compensation. Instead, it applies to the top five highest paid employees with wages in excess of $1 million and includes benefits in the definition of compensation. This proposal, while likely not to get much traction this year, is another reminder of the emphasis placed on executive compensation and the need to develop a detailed process for setting and reporting compensation.

Author: *Sarah McConnell, CPA, Principal,*
smcconnell@johnsonlambert.com