Executive Compensation: Intermediate Sanctions & IRS Form 990 Overview

Webinar
July 2011
II. Regulatory/Legislative Environment
Regulatory Considerations

There are two key areas in this section:

- "Intermediate Sanctions" regulations that require compliance with certain provisions of the United States Internal Revenue Code.

- IRS Form 990 now requires a greater level of detail in the information to be reported to the IRS each year.
Intermediate Sanctions: IRC Section 4958

Adopted in 1996, Section 4958 of the Internal Revenue Code:

- Addresses “excessive benefit transactions” for non-profit executives in 501(c)3’s and 501(c)4’s.
  - **Definition of “Excessive Benefit Transaction”:** The value of the benefit to the executive (consisting of base pay, incentive or bonus pay, standard and supplemental benefits and perquisites) exceeds the value of the services provided to the organization.

- Requires reporting of compensation to officers and key executives known as “disqualified persons”.
  - “Disqualified persons” are those executives who exercise substantial influence over the affairs of the organizations, such as supervising the management, administration or operations of the organization.
  - Chief Executive Officers are automatically included as “disqualified persons”.
  - Family members of “disqualified persons” employed by the organization also are subject to scrutiny.
Intermediate Sanctions: Penalties

If compensation is determined to be excessive, excise taxes are imposed on the amount of compensation determined to be excessive.

*Penalties to the Disqualified Person(s)*

- 25% of the excess amount and reimbursement of the excess to the organization within the taxable period.
- 200% of the excess amount if not corrected within the taxable period.

*Penalties to Organization Managers Who Approved Transaction*

- 10% of the excess amount assessed to any organization manager (Board or Committee member) who knowingly participated in an excess benefit transaction.

These excise taxes are “intermediate sanctions” since, prior to enactment of this legislation, the only recourse available was revocation of the organization’s tax exempt status.
Intermediate Sanctions: Rebuttable Presumption

Under Section 4958, an organization can defend against a claim that compensation is excessive through a “three-pronged” defense:

- The compensation arrangement must be approved in advance by an authorized body of the applicable tax-exempt organization, which is composed of individuals who do not have a conflict of interest concerning the transaction,
- Prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability, and
- The authorized body adequately and timely documented the basis for its determination concurrently with making that determination.  

The documentation of the authorized body should include the terms of the transaction and the date of its approval, the members of the authorized body present during the debate and vote on the transaction, the comparability data obtained and relied upon, the actions of any members of the authorized body having a conflict of interest, and documentation of the basis for the determination.  

1 From IRS.gov website – last updated August 18, 2010
IRS Form 990

The IRS Form 990 (tax return for exempt organizations) was revised substantially for the 2008 tax year, the first significant change since 1979.

This latest redesign is a more sweeping move to tie together the monitoring and reporting requirements of key legislation affecting compensation and organizational governance, and to provide clear guidance to assure consistent reporting of information. It gives organizations the opportunity:

• To report information regarding mission-related activities and achievements,
• To describe governance processes, and
• To explain any out-of-the-ordinary elements of compensation and the rationale for providing them.

Because of this greater level of transparency, the 990 has become an even more useful tool for stakeholders and the public to obtain information about public charities, in addition to assuring compliance with regulatory requirements.
How the 990 Supports Compliance

The redesigned 990 requests information that will serve to promote compliance with Intermediate Sanctions and Sarbanes-Oxley legislation:

- Requests information regarding governing body and “independence” of members.
- Requests information regarding organizational policies (conflict of interest, whistleblower, document retention and destruction).
- Verifies that processes are in place for regular review of the compensation provided to CEO, officers and key employees.
- Requires reporting of compensation for:
  - Directors, officers and trustees, regardless of level of compensation
  - 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 Relating to Compensation Practices

- **Part VI – Governance, Management, and Disclosure**
  - **Section A. Governing Body and Management**
    - #1b. Number of voting members that are “independent”
    - #8a and 8b. “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** – report any compensation received from the organization and related organizations

- **Schedule J**
  - **Part I** – Reporting of elements of compensation and basis for establishing compensation of the CEO/Executive Director.
  - **Part II** – More detailed breakdown of elements of compensation and reporting of compensation from prior filing.
  - **Part III** – Opportunity to provide information, explain or describe elements of compensation

- **Schedule O – Supplemental Information**
  - Typically used to describe in detail the process used to establish compensation for the CEO and other executives.
Questions?

For further information, please contact:

JER HR Group, LLC  
36 West 44th Street  
Suite 707A  
New York, NY 10036  
(646) 453-7560

jerocco@jerhrgroup.com  
lfbeers@jerhrgroup.com