

# Executive Compensation & the 990

**Amy K. Chapman, Principal**  
**[Amy.chapman@CLAconnect.com](mailto:Amy.chapman@CLAconnect.com)**  
**407-802-1200**

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC,  
an SEC-registered investment advisor. | ©2017 CliftonLarsonAllen LLP



# Learning Objectives

At the end of this session, you will be able to:

- Identify “reasonable” compensation
- Establish procedures to justify reasonable compensation and benefits
- Report compensation accurately on Form 990
- Quiz





# Executive Compensation in the Spotlight

A well known charity benefiting disadvantaged youths announces several local chapters are closing their doors because of budget shortfalls!

- The CEO receives compensation of \$900,000!
- Politicians, funders, and the media rush to criticize!
- Negative public opinion and perception!

*“Nonprofit CEOs Who Want For-Profit Salaries Should Work at For-Profit Companies”*

“Why do people believe that we can retain the trust of the public when we pay people at outrageous levels like this?”

*“Nonprofit executives  
should be paid less.”*

- Government grantors don't like it.
- Individual donors don't like it.
- The most effective leaders are passionate about the work, not the salary.



*“Nonprofit executives  
should not be paid less.”*

- The organization is charitable, not the employees.
- To attract and retain talented executives, you must compete with the entire job market (“You get what you pay for”).
- Highly complex organizations requiring extensive management *and* fundraising expertise
- The fact that the organization is exempt from federal income tax has nothing to do with the fair market value of the services the executives are providing.

# Charity Navigator 2014 CEO Compensation Study

- Surveyed 3,929 charities
- 2% of charities pay the top executive over \$500,000
- Majority of those are large, over \$13.5 million in expenses
- Geographic differences: Highest in Northeast, lowest in Southwest
- Mission differences: Highest in Education, lowest in Religious
- 95% claim to follow the 3-step rebuttable presumption of reasonableness



# Definitions

## Private Benefit

When a 501(c)(3) operates in a way that benefits private interests

Defense: The activity is *incidental*

# Private Inurement

When a 501(c)(3) or (4) operates in a way that unreasonably benefits an insider

- Unreasonable compensation and benefits, personal use of organization assets, low-interest loans, reimbursement of personal expenses, sales below FMV, purchases above FMV
- Excess Benefit Transaction
- Automatic Excess Benefit Transaction
- Defense: The activity is *reasonable*

## Excess Benefit

When any nonprofit organization overcompensates an insider

- Fair Market Value: what similar organizations in a similar geography pay for similar services in similar circumstance
- Intermediate Sanctions = Excise Tax
  - 25% on the executive
  - 10% of Board members who willfully approved (joint and several liability, max \$20,000)
- Potential Revocation

## Excise Tax Example

- A 501(c)(3) public charity obtains a compensation survey that indicates comparable compensation packages of \$200-\$300,000.
- The compensation committee approves a CEO salary of \$350,000 and thoroughly documents the process.
- IRS determines an excess benefit of \$50,000.
- Excise tax on the CEO: \$12,500
- Excise tax on executive committee: \$5,000
- Year 2: \$100,000 on CEO

# Rebuttable Presumption of Reasonableness

1. Compensation for officers and key employees is determined by independent members of the governing body or compensation committee
2. Compensation levels are being set based on comparability data for similar positions at similar organizations
3. Organization is documenting the decision-making process

# Rebuttable Presumption of Reasonableness

- Top Management Official
  - CEO/President/Executive Director
- Other Officers
  - As defined in Bylaws
  - Top Financial Official
- Key employees
  - Compensation > \$150,000
  - Responsibilities similar to officers
  - Responsibility over 10% of organization activities or budget



990

## Where is this in the 990?

- **Part VI, Section B. Policies**
- Line 15....It says..."Did the process for determining compensation of the following persons include a review & approval by independent person, comparability data, and contemporaneous sustentation of the deliberation & decision?"
- Don't forget **Schedule O**

# Compensation Considerations

1. Background, experience, and education
2. Importance to the organization's success
3. Difficult to replace
4. Organization is large and complex.
5. Hours, duties, responsibilities
6. Adherence to a documented policy
7. Does the compensation conform to the organization's basic salary policy?
8. Robust, professional compensation study/survey?
9. Compensation was demonstrably low in prior years
10. Reasonable ceiling on revenue- or income- based incentives.
11. If the current compensation includes payments for services rendered in past years, was the employee underpaid in those years?
12. Is the compensation disguising a purchase of assets or the distribution of profits?
13. Have all potential conflicts of interest been identified and resolved?
14. Does the executive exert undue influence over the governing body?
15. Would a prudent investor consider this adequate return on investment?

# Form 990 Reporting

- Part VII

(A) Name and Title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highly compensated employee	Former			
(1)										
(2)										
(3)										

## Schedule J

(A) Name and Title		(B) Breakdown of W-2 and/or 1099-MISC compensation			(C) Retirement and other deferred compensation	(D) Nontaxable benefits	(E) Total of columns (B)(i)-(D)	(F) Compensation in column (B) reported as deferred on prior Form 990
		(i) Base compensation	(ii) Bonus & incentive compensation	(iii) Other reportable compensation				
1	(i)							
	(ii)							
2	(i)							
	(ii)							
3	(i)							
	(ii)							
4	(i)							
	(ii)							
5	(i)							
	(ii)							

# Form 990 Reporting

## Examples of Compensation:

- Wages, bonuses, severance, sick/vacation pay cash-outs
- All Taxable deferred comp, employee elections to 401(k) or 403(b), deferrals by employer or employee under 457(b) if substantially vested, deferrals under a nonqualified defined contribution plan if substantially vested, distributions from a nongovernmental 457(b), taxable income under 457(f)

# Form 990 Reporting

## Examples of Compensation:

- Tax gross-ups, debt forgiveness, stock options when exercised
- Other taxable benefits, including health, scholarships and fellowships, flexible spending accounts, life/disability/long-term care insurance, split dollar life insurance, housing allowance, legal services, financial services, dependent care, adoption assistance, tuition assistance, personal use of company car, personal travel, moving expenses, social club dues, spending accounts without an accountable plan, gift cards

# Form 990 Reporting

## Examples of Deferred Compensation:

- Employer contributions to a qualified retirement plan
- Accruals of retirement plan benefits
- Deferrals by employer or employee under 457(b) if not substantially vested, deferrals under a nonqualified defined contribution plan if not substantially vested
- Stock options when granted

# Form 990 Reporting

## Examples of Other Benefits:

- Health benefit premiums
- Nontaxable flexible spending accounts
- Certain nontaxable benefits above \$10,000 may be omitted from Part VII, but must be included in Schedule J: nontaxable life/disability/long-term care insurance, housing allowance, legal services, financial services, dependent care, adoption assistance, tuition assistance

## Form 990, Page 7, Part VII Compensation- Common mistakes

1. Report amounts from Calendar year not fiscal year
2. Column (A) – list all officers, directors, trustees, Key employees and HCE's
3. Column (B) – Average hours per week?
4. Column (C) – What boxes to check?

# Form 990, Page 7, Part VII Compensation- Common mistakes

## 4. Column (C) – Position mix up

- If you are an Officer, CFO, You are not a Key Employee and Highly Compensated Employee (HCE)
- Key Employee: 3 tests have to be met
  1. \$150,000 Test
  2. Responsibility Test
  3. Top 20 Test
- HCE – How many should be listed?
  - ◇ What is the threshold?

## Form 990, Page 7, Part VII Compensation- Common mistakes

5. Column (D & E) – Highest number on the W-2 or 1099-Misc from the Organization or Related Organization
6. Column (F) - don't leave blank

# Form 990, Page 7, Part VII Compensation- Common mistakes

- When in doubt- try the instructions
  - Good examples
  - Definition of terms
  - Tables with different types of compensation and where to report on page 7 and Schedule J

# Form 990 Reporting

## Not reported:

- Fringe benefits – *de-minimus*
- Parking
- Personal use of company computer/printer/phone
- Meals provided for the convenience of the employer
- Business use of company car
- Christmas ham
- Expense reimbursements under an accountable plan
- Employer portion of payroll taxes

# Automatic Excess Benefit Transactions

## **WARNING: Unreported Compensation**

- Failure to report any taxable element of compensation on Form 990, even if its inclusion would have been reasonable.
- Form 990 must be amended prior to IRS exam
- Failure to report nontaxable benefits is not an *automatic* excess benefit transaction, although if unreasonable it may be considered an excess benefit.

# Executive Privileges

## Look For:

- First Class/Charter travel
- Travel for companions
- Housing allowances
- Expense reimbursements without an accountable plan
- Club dues
- Use of personal residence
- Tax return preparation
- Personal trainer, babysitter, pet sitter, chef, concierge

## Personal Use of Company Car

- Taxable fringe benefit
- Log personal miles
- Commute is *personal* use
- Use the IRS Lease Value Rule to compute the value of personal
- If the company pays for the fuel, add 5.5 cents/mile for the personal miles

## Form 990, Schedule J Compensation Information

- Where the IRS and the reader want to know more about reportable compensation for individuals greater than \$150,000
- Part I – relates back to slide 27. What is else is the Organization providing. Can provide additional information in Part III
- Part II – gives more detail those listed on page 7 with Compensation greater than \$150K

## Schedule J Example:

- Steven Jones, Executive Director
  - Base compensation is \$140,000
  - Bonus paid \$15,000
  - Vacation/sick leave cashed out - \$2000
  - Health Care premiums - \$12,000
  - Contribution by employer to qualified retirement plan - \$5,000
- What does Schedule J Look like?

# Schedule J Example

Schedule J (Form 990) 2016

Page **2**

## Part II Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees. Use duplicate copies if additional space is needed.

For each individual whose compensation must be reported on Schedule J, report compensation from the organization on row (i) and from related organizations, described in the instructions, on row (ii). Do not list any individuals that aren't listed on Form 990, Part VII.

**Note:** The sum of columns (B)(i)–(iii) for each listed individual must equal the total amount of Form 990, Part VII, Section A, line 1a, applicable column (D) and (E) amounts for that individual.

(A) Name and Title		(B) Breakdown of W-2 and/or 1099-MISC compensation			(C) Retirement and other deferred compensation	(D) Nontaxable benefits	(E) Total of columns (B)(i)–(D)	(F) Compensation in column (B) reported as deferred on prior Form 990
		(i) Base compensation	(ii) Bonus & incentive compensation	(iii) Other reportable compensation				
1 Steven Jones, Executive Director	(i)	140,000	15,000	2,000	5,000	12,000	174,000	
	(ii)							
2	(i)							
	(ii)							
3	(i)							
	(ii)							
	(i)							

# IRS Audit

- What if IRS comes knocking...

# IRS Information Document Request (IDR)

- Employment contracts
- Compensation surveys and reports
- Compensation policy
- Board minutes and other documentation of the process
- Loans or other transactions
- Form 990 for previous and subsequent year
- W-2s and 1099s

# Quiz:

# Disclaimers

*The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the user. The user also is cautioned that this material may not be applicable to, or suitable for, the user's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The user should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the user of any changes in tax laws or other factors that could affect the information contained herein.*

# Questions?

**Amy K Chapman, CPA, CFE**  
**Principal**  
**Amy.Chapman@CLAconnect.com**  
**407-802-1200**



*All of the materials contained in this course have been created by and belong solely to CliftonLarsonAllen LLP. Tax advice contained herein is not intended to be used and cannot be used for the purpose of avoiding tax-related penalties that may be imposed on the taxpayer. This content does not constitute legal advice and no liability is assumed whatsoever in connection with its use.*

**CLAconnect.com**

