BOARD MEMBER COMPENSATION

HOW MUCH IS TOO MUCH?

PREPARED BY

BARBARA THEOFILOS, CPA, MBA
Tax Services Manager

DEANNA ALGER, CPA, MBA
Accounting and Tax Services Senior

ANDRES RIOS
Intern

zinner&co.
Certified Public Accountants
Management Consultants
Since 1938

3201 Enterprise Parkway, Suite 410 • Beachwood, OH 44122
P: 216.831.0733 • F: 216.765.7118 • zinnerco.com

INTRODUCTION

Thank you for downloading Board Member Compensation: How Much is Too Much? We receive many questions from clients regarding this subject. The content in this publication will provide valuable insight into this complicated tax area. Due to the tax-exempt nature of not-for-profit organizations, payments to influential members of an organization are more closely examined.

The content in this publication will help you understand the IRS rules for board member compensation as well as the reporting requirements regarding compensation paid to board members who are volunteers, employees, or independent contractors.

If you have questions about the content in this Ebook or any other accounting, tax, or business management issues, contact us at 216.831.0733 or info@zinnerco.com. Our professionals are ready to start the conversation.

BOARD COMPENSATION

Major scandals have rocked the not-for-profit financial world in recent years, affecting organizations such as Hale House, Help Hospitalized Veterans, and Central Asia Institute. Because of this, donors, the media, regulators, and the general public became increasingly skeptical of the integrity of not-for-profits, and one of the major areas under scrutiny is compensation.

Under IRS regulations, not-for-profit organizations (NPOs) are legally allowed to pay fair wages and compensation to employees, including board members. NPOs must know the limits of compensation allowed to be paid to their board members to avoid legal and financial issues. Excessive or disqualified payments made to the board of directors may result in taxes and fees, and in extreme situations, may even lead to revocation of the organization's tax-exempt status. Excessive compensation also adds to a donors' skepticism of a public charity. To avoid a costly mistake, NPOs should take three steps to help ensure that their organization is properly compensating and reporting.

STEP ONE
Determine the proper classification of the organization's board members, volunteers, employees, and independent contractors.

Board Members as Volunteers

Most board members of NPOs are volunteers, invited to join the board based on their expertise and dedication to the organization's purpose.

All of the following must be true for an individual to be considered a volunteer:

- The entity that benefits is a not-for-profit or government agency
- The activity is less than full-time
- The services are not offered as a result of coercion
- The services are typically associated with volunteer work
- Regular employees have not been displaced by the volunteer
- The volunteer does not expect to be compensated

If a board member meets these qualifications, then he or she is considered a volunteer.

Board Members as Employees or Independent Contractors

It's important to understand that, although an NPO's income is exempt from taxation, the NPO is not exempt from payroll taxes on wages paid to its employees. The designation of board members as employees or independent contractors affects the organization's withholding and tax obligations, as an employee is subject to various withholding taxes, where an independent contractor is not. NPOs are responsible for withholding the proper state and local taxes from their employees, as well as withholding the appropriate amounts for FICA, Medicare, and Federal Income taxes. NPOs can also be subject to Federal Unemployment Tax (FUTA) and State Unemployment Tax (SUTA). Note, that while only 501(c)(3) organizations are exempt from paying FUTA tax, they may still be required to pay SUTA.

It is important to understand the fundamental differences between the two classifications, employee and independent contractor, and follow the appropriate IRS reporting requirements for whichever is applicable. The following chart can help to determine the classification of a board member:

	Behavioral Control	Financial Control	Type of Relationship
Employee	The NPO directs what should be done and how it should be done.	• NPO controls aspects of the job such as reimbursable expenses. • Minimal or no investment on an employee's part to perform the service • NPO controls how the employee is paid.	• Written contract documenting that the individual is an employee. • Worker receives benefits. • Expectation of job permanence. • Worker's job is a key function in the regular business activity of the organization.
Independent Contractor	The NPO can specify the finished product or service, but the contractor exercises freedom in the methods and tools used to perform the service. Organization has no control as to how job should be done.	• Contractor determines the billing amount as well as reimbursable expenses. • Contractor makes significant investment in tools and supplies to complete the job. • Contractor has ability to recognize profit or loss on the job.	• Written contract documenting the relationship between parties indicating a temporary period in which services will be performed. • Contractor does not receive employee benefits.

If your not-for-profit organization is unsure about determining the status of a worker, then either file Form SS-8 with the IRS to have them determine the relationship or contact a Zinner and Co. tax professional for assistance.

STEP TWO
Determine the proper amount of compensation for board members

The majority of public charities do NOT compensate their board members. Typically, board members are reimbursed for reasonable and necessary expenses incurred in connection with their service to the NPO.

Compensation for Volunteer Board Members

It's reasonable to want to give a volunteer "something" for their time and efforts. Nevertheless, a volunteer is someone who donates his or her time and services with no expectation of compensation. Two issues arise when compensating a volunteer board member:

1. Payments to a volunteer may inadvertently turn the volunteer into an employee in which case the organization would carry all responsibilities and risks that accompany an employee, such as withholding and paying applicable payroll taxes. Once volunteers are paid more than $500, or 20% of the fair market value of compensation to an employee performing the same functions, the volunteers become employees, and the organization becomes responsible for the resulting tax liability.

2. A volunteer board member is a disqualified person and payments made to the individual may be examined by taxing authorities.

The IRS recognizes the value of the services that volunteers offer and, accordingly, the IRS permits certain payments to volunteers. NPOs would be wise to adhere to a policy on volunteer compensation that does not jeopardize the organization's tax-exempt status. There are multiple factors to consider when compensating volunteer board members. The NPO can reimburse a volunteer's out-of-pocket expenses or pay a uniform allowance, creating a reporting requirement for the organization. Alternatively, volunteers can deduct their expenses as charitable contributions or they can exclude the value of certain fringe benefits from income. Excludable fringe benefits do not have to be reported to the IRS. The following example demonstrates the application of the different options.

EXAMPLE

The board of an NPO meets once a month. The nearest available parking costs $15, and there are other lots in the area at different rates. The $15 lot is the most convenient but a board member can choose to park there or elsewhere. There are four board members, and they all choose different commuting options:

- Board member A walks
- Board member B parks once at a $10 Lot
- Board member C comes twice a month and parks in the $15 lot
- Board member D comes four times a month and parks in the $15 lot

The NPO believes that making the board members pay for parking discourages their attendance. Preferring to have all of the board members present at all meetings, the NPO wants to reimburse board members for their parking expense.

A. Reimbursed Expenses

NPOs are permitted to reimburse volunteers for particular expenses as long as the volunteer has adequate documentation to prove that the expense was incurred for the NPO. The organization has the option to operate under an accountable reimbursement plan or a nonaccountable reimbursement plan.

An *accountable plan* is an agreement under which the NPO reimburses its employees for business expenses incurred. For a plan to be an accountable plan, it must meet certain conditions. First, there must be a business purpose behind the expense. Second, the employee must be able to substantiate the expense. Finally, any excess reimbursement must be returned to the employer within a reasonable time. Reimbursements under an accountable plan can be excluded from the employees' income and do not have to be reported to the IRS. *In this scenario, board member A would not have any reimbursable expenses, and board members B, C, and D must provide the employer proof that the expense was incurred. Once reimbursed, the payment is not included in wages and is not reported as income; any excess reimbursement should be returned to the employer promptly. Any excess not returned is considered income and must be reported and taxed accordingly.*

A *nonaccountable plan* is a reimbursement plan that does not meet all the requirements for an accountable plan. The tax implications for a nonaccountable plan are different than those of an accountable plan. Whereas accountable plan reimbursements do not have to be reported and are not classified as income to the recipient, nonaccountable plan reimbursements are included in income, and the expenses are deducted as charitable contributions. *In this scenario, board member A does not claim any expenses. Board member B, C, and D claim the actual expenses incurred. When board members are reimbursed, the reimbursement is reportable as income on a W-2 and the expense is considered a charitable contribution on the individual's tax return.*

B. Avoid payments to the board members

By not paying volunteer board members, the organization shifts the tax obligations to the board member. The board members can then deduct the costs incurred while volunteering on Schedule A of their personal tax returns. In this scenario, the board members that incurred parking expenses can include these costs as charitable contributions on Schedule A of their tax return.

C. Create a uniform stipend

For expenses that are difficult to track or those that may vary among individuals, it may be better to set up a uniform payment that covers the average cost that individuals incur, also known as a stipend. Stipends are included in income, and the associated expenses incurred by the individual are deducted as charitable contributions. *In this scenario, the organization reasonably assumes that board members will use the $15 dollar lot and that amount is paid as the stipend. Board Members A, B, C, and D all report the stipend as income. The organization must report the stipend on a W-2. The stipend is also subject to payroll tax withholding. The actual expenses incurred by board members B, C, and D are reported on the individuals' tax returns as charitable contributions.*

D. Treat the parking as a fringe benefit to the volunteer

A de minimis benefit is any property or service that is provided to an employee that has minimal value (taking into account how frequently you provide similar benefits to your employees) such that accounting for the receipt of such benefit would be unreasonable or administratively impractical. IRS regulations allow de minimis benefits to be excluded from income. An example of one such benefit is providing an employee with qualified parking. To exclude parking from a volunteer's income, the cost of parking must be less than $255 per month. Normally, any cash or cash equivalent benefit is included as income, but there is a special exception for qualified parking and transportation costs. The cash benefit can only be excluded from income if there is no voucher or equivalent for parking. Furthermore, this voucher must not be convertible into cash. *For this scenario, the parking comes in at less than $255 a month and the NPO deems it necessary for the board member's fulfillment of job duties. If the parking lot offers parking passes, the NPO must purchase the passes and then provide them to board members. The* *value of these passes is not included in income. If there are no such passes for this lot, the cash benefit given to the individual can be excluded from income. If parking passes do exist and the NPO provides the board members with cash instead, the cash is reportable as income to the individual on a W-2.*

Disclaimer: The requirements for individual fringe benefits and their tax treatment depend on multiple variables, so it is important to consult a tax professional or perform due diligence before taking any action. More information on fringe benefits is provided at the end of this section.

Employee and Independent Contractor Board Member Compensation

Not-for-profit organizations are legally allowed to reasonably compensate an employee or an independent contractor for services performed. If a board member is paid more than fair market value for their services or is paid an excessive amount in relation to the amount of time invested in the organization, there is the risk of an excess benefit transaction. The IRS may levy a 20% excise tax on excess benefit transactions. In determining whether or not an excess benefit transaction occurred, the IRS will examine all facts and circumstances surrounding the case. A “rebuttable presumption” can provide support against claims of excessive benefit transactions. To create an adequate rebuttable presumption, consider the following:

1. The transaction must be approved in advance by disinterested members of the organization’s governing body or a committee therein permitted to act on behalf of the board by state law.

2. The governing body must obtain and rely on valid comparability data on compensation of similar officers, for similar size, and similar function organizations, both taxable and tax-exempt.

3. The governing body must contemporaneously document its decision and the reason for the decision. The decision must be documented before the later of the approving body’s next meeting or 60 days after the final action of the approving body. Documentation includes the terms of the transaction, date of approval, members who were present during the discussion and voted on the transaction, a description of comparability data used and how it was obtained, actions taken by members who had a conflict of interest, and if the compensation exceeds fair market value the members of the authorizing body must record the basis for its determination.

Fringe Benefits to Board Members

Fringe benefits are included or excluded from income based on the frequency, amount, and type of worker (volunteer, independent contractor, employee). The IRS determines that the following qualified fringe benefits are an expense of so little value that accounting for it would be unreasonable and impractical:

- Services provided to employees at no additional cost to your organization.
- Working condition fringes of property or services such as a company car for business use or subscriptions to business magazines may be deducted.
- Certain minimal value fringes (including an occasional cab ride when an employee must work overtime and meals you provide at restaurant establishments you run for your employees if the meals aren't furnished at below cost).
- Qualified transportation fringes subject to specified conditions and limited to $255 per month for combined transit passes, or $255 per month for qualified parking.
- Occasional typing of personal letters by a company secretary.
- Occasional personal use of an employer's copying machine.
- Group meals, or picnics for employees and their guests.
- Traditional birthday or holiday gifts of property (e.g. a Thanksgiving turkey) with a low fair market value.
- Occasional theater or sporting event tickets.
- Coffee, donuts, and soft drinks.
- Flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., an illness, outstanding performance, or family crisis).
- Employer-provided cell phones provided primarily for a non-compensatory business reason.

Inclusion/exclusion and reporting rules vary for different fringe benefits. Consult IRS Publication 15-B for more information on fringe benefits, or consult any of our tax professionals.

STEP THREE
Report information regarding board members on IRS form 990

Reporting Requirements for all types of Board Members

Whether a board member is an independent contractor, employee, or volunteer, the board member is listed in Part VII of Form 990, along with other important members of the organization.

Overview and Terms

Part VII of Form 990 is used to report an organization's current or former directors, trustees, officers, key employees, highly compensated employees, and independent contractors along with compensation paid to those individuals during the calendar year that meets certain reporting thresholds.

The core of the form is Section A - a schedule made up of 6 columns (A, B, C, D, E, and F) detailing the individual's position, hours devoted to the organization, reportable compensation, reportable compensation paid to the individual by a related organization and "other compensation" paid to the individual by the filing organization and any related organizations. Following Schedule A, lines 3, 4, and 5 require more detail about compensation that exceeds certain other thresholds. If you answer "yes" to line 3, 4, or 5 you must also complete and file Schedule J with your Form 990. Section B reports the five highest compensated independent contractors that received over $100,000 of reportable compensation in the calendar year.

Understanding the terms used in Part VII of Form 990 is required to complete the form accurately. The following table defines some of the important terms used in Part VII.

Directors or Trustee	• Member of the organization's governing body with voting rights. • An "institutional trustee" such as a bank or trust company. • Report regardless of compensation for the calendar year (no threshold).

Officers	• Person elected or appointed to manage the organization's daily operations.
	• President, vice president, secretary, treasurer.
	• Treat as an officer, regardless of title:
	  • Top management official who has ultimate responsibility for implementing the decisions of the governing body (CEO, executive director).
	  • Top financial official who has ultimate responsibility for managing the organization's finances (Treasurer, CFO).
	• If multiple individuals exercise the same responsibility (co-presidents, co-treasurers), treat all such individuals as officers.

Key Employees	• Must meet ALL three of the following tests:
	  • **$150,000 test**: Receives reportable compensation from the organization or related organization greater than $150,000 for the calendar year ending within the organization's tax year.
	  • **Responsibilities test**: Has responsibilities similar to that of officers, directors, and trustees, or; manages a discrete segment or activity that is 10% or more of the organization's activities, income, assets, or expenses, or; has or shares authority to control or determine 10% or more of the organization's capital expenditures, operating budget, or compensation for employees.
	  • **Top 20 Test**: Is one of 20 employees (other than officers, directors and trustees) with the highest reportable compensation and satisfies the $150,000 test and the responsibility test described above.

Highly Compensated Employees	• Up to the five highest compensated employees who have over $100,000 reportable compensation for the calendar year ending with or within the organization's tax year.
Highly Compensated Independent Contractors	• Up to the five highest compensated independent contractors paid over $100,000 reportable compensation for the calendar year ending with or within the organization's tax year.

Reportable Compensation	• Officers and employees: Amounts required to be reported on box 1 or 5 (whichever is greater) on Form W2 or any amounts on box 7 of Form 1099MISC. • Directors and trustees: Amounts required to be reported on Form 1099MISC box 7, or any amounts on boxes 1 or 5 (whichever is greater) of Form W2. • Institutional Trustees: Fees for services paid pursuant to a contractual agreement or statutory entitlement.

Other Compensation	• Other compensation includes benefits over $10,000 not currently reported on boxes 1 or 5 of Form W2 or box 7 on Form 1099MISC (See $10,000 exceptions below).
	• Reported regardless of amount:
	  • Tax deferred contributions by employer to a qualified defined contribution retirement plan.
	  • The annual increase or decrease in actuarial value of a qualified defined benefit plan.
	  • The value of health benefits provided by the employer or paid for by the employee with pre-tax dollars not included in reportable compensation.
	  • Tax deferred contributions by the employer and/or by the employee to a funded nonqualified defined contribution plan, and deferrals under an unfunded plan.
	  • The annual increase or decrease in actuarial value of a nonqualified defined benefit plan.

$10,000 per item exception for Other Compensation (Does not apply for Schedule J)	• Except for the five items listed above, neither the organization nor a related organization is required to report on Form 990 any item of other compensation if its total value is less than $10,000 for the calendar year ending with or within the organization's tax year. • If the individual's total compensation exceeds the relevant threshold, then amounts excluded under the $10,000 per item exception must be included in compensation reported on Schedule J.
$10,000 per related organization exception for related organizations (Does not apply for Schedule J)	• Reportable compensation is not required to be reported on Section A, Column (e) of part VII if it is $10,000 or less per related organization for the calendar year (except for the five items listed in "other compensation"). • If the individual's total compensation exceeds the relevant threshold, then amounts excluded under the $10,000 per related organization must be included in compensation reported on Schedule J.

It is important for the NPO to work with its accountant to accurately prepare Form 990. There are numerous rules and exceptions in place that need to be followed not only in the board member section, but also throughout the entire form. The following are examples of items that your accountant may request regarding the board members:

1. Names of all board members who served on the board at any time during the organization's fiscal year
2. Titles of all board members
3. Average hours worked per week by all board members
4. Compensation and nontaxable benefits of all board members on a calendar year basis
5. Average weekly hours and annual compensation of the top management official (the top management official in many cases is the executive director, CEO, or the organization's president)
6. Average weekly hours and annual compensation of the top financial official (the top financial official in many cases is the organization's treasurer or chief financial officer)

Keep in mind that both the top management official and the top financial official are both considered to be officers of the organization regardless of their titles. Since they are considered officers on the board, then it is mandatory to include their compensation on Form 990 where it is requested.

Also relating to compensation, the amounts reported on Part VII of Form 990 are reportable amounts for the calendar year. If your organization files Form 990 based on a fiscal year, it is possible that the amounts reported as compensation in Part VII do not agree to the compensation reported on Part IX of Form 990, line 5 on the functional expense statement. For example, if the NPO has a year end of June 30, 2017, then the calendar year wages to be reported on Part VII would be for the tax year 2016.

The questions listed above are only considered to be guidelines for what will need to be included on Form 990. The accountant working with the NPO will likely have additional questions and need additional clarification once the basic information is provided. Form 990 is a complex filing with numerous rules and guidelines to follow. We recommend contacting your accounting professional if you have any questions regarding the accurate preparation of this form.

SOURCES

IRS Instructions for Form 990

IRS Publication 15 – Employer's Guide to Employee Wages

IRS Publication 15a - Supplementary Tax Guide for Employer's

IRS Publication 15b – Fringe Benefits

IRS Publication 526 – Charitable Contributions

IRS Publication 557 - Tax Exempt Status for your Organization

Guidestar and 501(c) organizations -
https://www.guidestar.org/ViewCmsFile.aspx?ContentID=4744

https://nonprofitrisk.org/advice/faqs/boards-governance2.shtml

https://www.irs.gov/pub/irs-tege/governance_practices.pdf

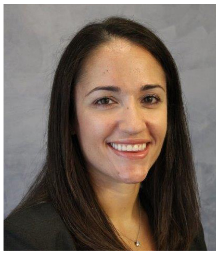
http://www.nonprofitrisk.org/library/articles/volunteer052004.shtml

http://tobijohnson.typepad.com/tobisblog/2013/06/volunteer-stipends.html

https://www.irs.gov/pub/irs-tege/eotopicj03.pdf?_ga=1.84929297.942075382.1466105828

https://www.irs.gov/pub/irs-pdf/p5137.pdf

ABOUT THE AUTHORS



Barbara Theofilos, CPA, MBA

Tax Services Manager

Barbara has been with the firm for over 10 years and is a member of the accounting and tax group and the not-for-profit team. In her supervisory role, Barb assists clients with the management, preparation, and filing of IRS Form 990 and 990-T returns, liaises with management to gather the required reporting information, and coordinates the necessary approval process, communicating closely with the institution's Board.

Barb's expertise with Federal and State rules, their regulations, and how they affect not-for-profit organizations has helped clients create strategies that meet their objectives and satisfy reporting requirements, including the understanding that Form 990 is a public document that may be used by external third parties for decision-making purposes.

Barb is a member of the Ohio Society of CPAs, the American Institute of CPAs and the Estate Planning Council of Cleveland. She earned her MBA from Cleveland State University and is a graduate of John Carroll University, where she earned her Bachelor of Science degree in business administration. Barb is a member of the Women Advancing Women organization and participates in community fundraisers, walks-a-thons, and special events.

DeAnna Alger, CPA, MBA

Accounting and Tax Services Senior

DeAnna has been with the firm for nine years and is a member of the accounting and tax department. In her role, DeAnna assists clients with the management, preparation, and filing of individual and corporate tax returns, gift tax, non-profit, and payroll returns.

DeAnna is a member of the Ohio Society of CPAs and the American Institute of CPAs. She earned her MBA and BA from Kent State University.

Andres Rios

Intern

Andres served Zinner & Co. as a tax and audit intern. He is currently a student at Case Western Reserve University, majoring in accounting.

A BIT ABOUT US...

In 1938, Harry Zinner had a vision for long term success. He founded a Cleveland-based bookkeeping firm that focused on integrity, commitment, and a pledge to help individuals, not-for-profit organizations and closely-held companies grow and prosper, not just for today, but for decades to follow.

Today, Zinner & Co. provides tax, accounting and management advisory services to guide businesses from startup to succession planning and help individuals create a solid financial foundation.

Our Beachwood, Ohio office is home to a dedicated team of CPAs and management advisors that provide a full slate of services beyond traditional tax and accounting. Contact us to discover how we can help you achieve your greatest financial potential.

www.zinnerco.com

216.831.0733
info@zinnerco.com