



*Strengthening Oklahoma's Safety Net,
One Community At A Time*

Board Bulletin

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IRS Executive Compensation Compliance Initiative

In a 2004 statement to the U.S. Senate Committee on Finance, the Commissioner of Internal Revenue referred legislators to the 2005-2009 Internal Revenue Service (IRS) Strategic Plan. The IRS Commissioner stated, "One of our four specific objectives is to deter abuse within tax-exempt and governmental entities, and misuse of these entities by third parties for tax avoidance or other unintended purposes." To begin the process, IRS sampled 1,826 tax-exempt organizations for compliance in 2004. As a result, the *Executive Compensation Compliance Initiative* was born. The initiative findings warrant further investigation by community health center (CHC) boards. To protect tax-exempt status and avoid hefty excise taxes for non-compliance, CHC stewards must understand IRS rules for executive compensation arrangements.

Section 501(c)3 of the Internal Revenue Code

◆ **May not inure private benefit** - A section 501(c)3 organization must be organized and operated exclusively for religious, charitable, scientific, or educational purposes. In addition, no part of the net earnings of the organization may inure (to become advantageous) to the benefit of any individual.

Executive Compensation Compliance Initiative Findings

◆ **Form 990 Reporting Errors** - The concerns uncovered from IRS' 2004 sampling of tax-exempt organizations centered around reporting issues. Over 30% of compliance check recipients had to amend their annual returns (Form 990s) because they failed to accurately report compensation. Fifteen percent (15%) were selected for further examination of their executive compensation practices.

◆ **Excess Benefit Transactions** - A taxable excess benefit transaction is any transaction that exceeds fair market value by which a tax-exempt organization provides an economic benefit (virtually anything of value) directly or indirectly to or for the use of any disqualified person. "Disqualified persons" include board members and senior management. Types of excess benefits include compensation, loans, guaranties, property, use of property, gifts, payment of personal expenses, free or discounted benefits. Rather than revoke tax-exempt status, Section 4958 of Section 501(c)3 allows the IRS to impose excise taxes against disqualified persons who receive benefits from the nonprofit organization that exceed fair market value.

◆ **Excise Tax Assessments** - When compliance issues were found, significant excise tax assessments were imposed. An excise tax can be assessed to the individual who received the overpayment and on certain managers (board members) who knowingly approved the overpayment. IRS collected in excess of \$21 million in excise taxes against 40 disqualified persons or organization managers. Public charities, including health care entities, accounted for more than \$4 million of the total.

◆ **Executive Compensation Compliance** - Out of 50 public charities reporting compensation over \$250,000, none initially filed schedules detailing compensation paid to officers or employees (reporting error). Excessive salary and incentive compensation was at the top of the list of compliance issues giving rise to the \$21 million excise tax assessments. Generally, the high compensation findings were substantiated based on comparability data. However, only 51% of the organizations followed IRS rebuttal presumption for justifying compensation.

◆ **Rebuttal Presumption** - Boards must establish rebuttal presumption by adhering to **all three** of the following **steps in advance** of any payment being made to a disqualified person: **1)** The arrangement must be reviewed and approved by the governing board or a board committee acting within board-established procedures. None of the participating members of the board-authorized reviewing body may have a conflict of interest with respect to that payment arrangement; **2)** The authorized body must rely on appropriate objective data as to comparable arrangements prior to making its determination; and **3)** The authorized body must adequately document the basis for its decision concurrently in the minutes.

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