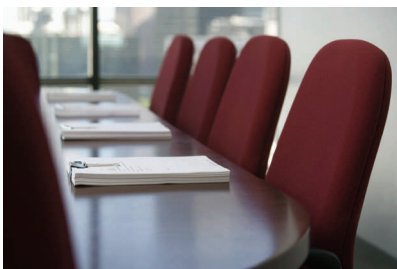


Business Accounting Measures, Inc.

"Helping you measure the heartbeat of your business"

## **COMPENSATION FOR TAX-EXEMPT ENTITIES**

Certain entities are classified as tax-exempt organizations to allow more of their efforts to benefit the communities they serve. Many tax-exempt organizations help the surrounding communities through charitable contributions from generous supporters. There are many safeguards put in place by the Internal Revenue Service to ensure these funds are managed properly. It is important to understand these requirements and to recognize the penalties for those who fail to abide by them.



Compensation and benefits are necessary expenditures for most tax-exempt organizations. To ensure that employees are not receiving unreasonable compensation, all forms of compensation and benefits, including de-

ferred compensation and some related-party transactions, must be disclosed annually to the IRS and the public on Form 990, *Return of Organization Exempt From Income Tax*. Intermediate sanctions were introduced in the mid-1990s to penalize those who receive such compensation and management who knowingly approve it. A public disclosure of the intermediate sanctions is also required on Form 990, which can be embarrassing for the organization and its leadership.

Penalties for individuals who receive compensation and benefits that exceed the fair market value of the services provided are as follows:

- They must repay the excess benefit with interest.
- They must pay a penalty of 25% of the excess over fair market value.

Penalties for managers who knowingly approve of the excess benefit must pay a

penalty of 10% of the excess over fair market value, capped at \$20,000.



It is important for entities to have established practices that ensure compensation is reasonable. Compensation should be decided by board approval, taking into consideration comparable organizations and their compensation. Finally, the actions taken when deciding appropriate compensation should be thoroughly documented to support the decisions made. These steps establish a presumption of reasonableness and in turn shifts the burden of proving that compensation is unreasonable to the IRS. Learn more about the regulations for tax-exempt entities at [www.irs.gov](http://www.irs.gov).