



## **Sleeper Legislative Issue: Board Compensation**

*By Bruce R. Hopkins*

The Senate Finance Committee is readying legislation that will, if enacted, impose a battery of new rules and penalties on charities, other tax-exempt organizations and those who assist them. The buzzwords underlying and guiding this legislative frenzy are: *accountability, transparency* and *governance*.

### **The Greatest Unknown**

It is the element of *governance* that presents the greatest unknown. In the aftermath of scandals in the for-profit arena and enactment of the Sarbanes-Oxley Act, it is obvious that newly emerging corporate governance principles are rapidly seeping into the nonprofit sector without any direct impetus from Congress.

The duties and responsibilities of board members — historically the province of state law — are being considered suitable topics for federal tax law. Related to all of this is the sensitive subject of board member liability.

### **Compensation for Board Member Liability**

Out of this debate and newly evolving practices has grown the general belief that the function of the modern nonprofit board is dramatically changing. On its way out is the passive, overseer board, and coming in is the active, hands-on, management-oriented board.

The latter approach, of course, entails more time and presents the potential for more personal liability. Some board members are resolving this dilemma by resigning. Others, however, are assuming a different position: They want to be compensated for their services and exposure to liability.

There is not much to say about the law and nonprofit board compensation because the practice is so uncommon. The law is clear that board member compensation must be reasonable and, in the case of public charities and social welfare organizations, subject to the intermediate sanctions rules.

Traditionally, the process of determining the reasonableness of compensation depends on data as to comparability of compensation being paid. In the board compensation area, however, there is little data because this type of payment is infrequent and the data imperfectly collected.

### **Compensation And The Law**

What is to be done, from the nonprofit organization's standpoint, when the board, or some members of the board, desire to be paid? At this stage of law development, the safest course is to avoid the practice. If compensation is unavoidable, the nonprofit organization is best advised to: 1) adequately document the reasons for the compensation and, 2) be certain that it has a justifiable method to ascertain the reasonableness of the compensation.

Because of the private inurement doctrine, excessive board member compensation could cause the nonprofit payor to lose its tax-exempt status. A revisit to the three buzzwords recalls the term *transparency*. Under current law, and probably more so under coming law, this type of compensation is public information.

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