



Management Consulting to Independent
and International Schools Worldwide

LITTLEFORD & ASSOCIATES
— GLOBAL ISSUES | LOCAL SOLUTIONS —

Board Governance | Head Compensation | Mentoring Heads | Faculty Compensation & Evaluation | Fundraising | Leadership Transitions
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SECTION 4958 - "INTERMEDIATE SANCTIONS"

Posted on August 24, 2015

Access to Form 990

These regulations are intended to target "disqualified persons", also called "insiders", who in the opinion of the IRS, receive "excessive benefits" from 501 (c) (3) organizations, such as independent schools.

The definitions of "disqualified persons" "excess benefits", "rebuttable presumption of reasonableness" are key to understanding, and complying with the "Intermediate Sanctions" Act.

"Disqualified Person"

A "disqualified person" is a person who, with respect to any transaction, at any time during a five-year period beginning after September 15, 1995 and ending on the date of the transaction, was in a position to exercise substantial influence over the affairs of the organization. With respect to an independent school, an "insider" (disqualified person) could be (but not limited to) any of the following persons:

A president, head of school, business manager or chief financial officer;

a voting member of the board of trustees;

a family member of a "disqualified person" such as a spouse, children, grandchildren, siblings, ancestors, great grandchildren and spouses of children.

a person who has an interest of 35% or more in controlled entities (partnerships or trusts and estates) and/or a corporation in which the "disqualified person" owns more than 35% of the combined voting power.

"Excess Benefit"

The regulations are designed to tax any and ALL arrangements that are considered an "excess benefit", defined as any benefit that an organization provides, that exceeds the fair market value of the goods and services that the organization receives in return. In simplest terms, if a head of school receives a salary of \$175,000, and the fair market value of her services in a comparable market is \$140,000, then the excess benefit is \$30,000.



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It is important to emphasize that excess benefit does not apply to salary and fringe benefits alone. The IRS definition includes the following, whether or not these are considered income for tax purposes: purchases, sales, and leases, or other transfers of value between the independent school and the insider; severance payments paid; plans providing medical, dental, life insurance and disability benefits; expense allowances; and foregone interest on loans.

Since deferred compensation has increasingly become a more important component of the total compensation package, the organization must further demonstrate that all forms of deferred compensation provided are of an amount that would have been paid by comparable tax-exempt entities for comparable services.

The penalty or tax imposed is equal to 25 percent of the excess benefit. If the transaction is not reversed, an additional penalty of 200 percent may be levied. Anyone who knowingly and willingly is a party to such a transaction can be subject to a 10 percent tax, not to exceed \$10,000 per "excess benefit transaction".

"Rebuttable Presumption of Reasonableness"

With respect to the compensation package, "rebuttable presumption of reasonableness" refers to the following: the presumption that the "consideration", i.e., the compensation, property, transfer of property, or any other benefit or privilege (see above) that the tax exempt organization provides to the "disqualified person" (Head) in exchange for his/her performance of services, is NOT an "excess benefit" and is REASONABLE.

The key question is, when is the tax-exempt organization, entitled to a "rebuttable presumption"? It is entitled when the organization follows the following procedures both in determining and in approving the compensation:

Establishes the Head of School or CEO of a 501 (c) (3) as a "disqualified person"

States the members of the decision-making body participating in the transaction discussion (the compensation committee); how they voted; and any action of a voting member having a conflict of interest (See below)

Cites the source of the comparability data that the committee used in making its decision; how that data was obtained; and examples of comparable data on all relevant components of the TOTAL package; (See below)

States the terms of the approved transaction or package and the date of decision and ratification by the compensation committee (See below)

Other Key Issues



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In order to have no conflict of interest, a member of the compensation committee must have no ties to the "disqualified" individual of a personal, relational or financial (including a vendor relationship) nature.

Comparability data is defined as industry surveys conducted by independent firms, documented compensation of persons holding similar positions in similar organizations, or expert compensation studies. It may be obtained by any means, including telephone calls.

If the compensation committee members are entirely independent, as stipulated by IRS regulations, and have been authorized by Board vote or by-laws to establish the Head or CEO's compensation and benefits, there is no need for Board ratification of the compensation package in order to obtain rebuttable presumption.

The Right To Access Form 990

Effective June 8, 1999, all 501 (c) (3) corporations will be required to send copies of their three most recent Form 990 on Head/CEO compensation to anyone who requests them. This includes their tax-exempt applications, their IRS tax-exemption letters, and "Schedule A" that reports deferred compensation programs.

If the request is made in person, non-profits must provide copies of the form immediately. If the request is made in writing, by fax, or e mail, non-profits have 30 days to mail out copies.

For every day that non-profit employees fall behind in delivering the forms, they are subject to fines of \$25 per day, up to a maximum of \$10,000 per return. In addition, an individual will be penalized \$5000 for willfully failing to deliver the forms.

With public access to the 990 permitted, it is crucial that non-profits ensure compliance with "safe harbor" regulations both in setting the level of head/CEO compensation and in designing the total package of salary and benefits.

John Littleford
Senior Partner