THE INTERMEDIATE SANCTIONS ACT: THE "NEXT LEVEL" OF COMPLIANCE

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The "Taxpayers' Rights Act", of which the "Safe Harbors Act" or the "Intermediate Sanctions Act" is a part, provides that every 501 C3 institution in the United States must annually review the CEO's compensation to ensure and document that it falls within a normal range for similar positions in similar institutions or meets criteria for "replacement costs." Heads of independent schools, nonprofit CEO's and their boards are appropriately paying much closer attention now to the language and interpretation of the Intermediate Sanctions Act to be certain that the school or nonprofit entity meets its legal requirements. More and more understand that through access to the 990 forms, the public can obtain and possibly misinterpret and/or misuse this compensation information, and that the penalties for non-compliance are severe both from the stand point of public relations and potential fines.

1. Does the Act Apply to the Head or CEO Only?

For protection against these financial and non-financial repercussions, "disinterested" members of an organization's board must review, approve and document every financial transaction between the organization and a person who could exercise substantial influence over the organization. This is to ensure that the transaction does not provide an "excess benefit" to that person. A "disinterested" person has no conflict of interest in a "financial transaction" referring to an agreement or transaction involving the organization's income, assets or property. An "excess benefit" is one greater than the fair market value of the benefit received by the organization and/or greater than similar benefits paid by comparable entities. The comparison must be made to at least five other like organizations.

Littleford and Associates has guided over 1500 organizations through the process of establishing total compensation levels for the head of school or CEO that attract, retain and reward these key individuals AND meet the requirements of the Intermediate Sanctions Act. In an independent school or nonprofit, the business manager, development officer, athletic director, assistant head, administrative or program director are among the top five highly compensated employees. As such, their compensation would be reported on the 990 and thus subject to public scrutiny.

Thus, schools are wise to ensure that the compensation of these individuals does not signal an "excess benefit" when attempting to attract and retain these valuable employees. Littleford and Associates, as result, is now serving an increasing number of not for profit clients by reviewing the compensation of their most senior and highly compensated employees to ensure compliance with the Act.

Leaders of nonprofits must recognize that the following are considered part of the total compensation of such highly compensated persons: housing or housing allowance and tuition for children at other schools loosely or formerly affiliated with the school.

A long-term teacher may also be one of the five highest paid employees whose salary would be listed on the 990. The Intermediate Sanctions Act would not cover a teacher's compensation, since a teacher is not in an "influential" position as defined by the IRS. Faculty or parents disgruntled about salary or tuition levels, however, could access and publicize this information and launch an attack. It has happened before.

1. Are Some Schools Exempt from Filing the 990?

Schools that are affiliated with a Church by virtue of their articles of incorporation are exempt from filing the 990, but some schools are "pushing the limits" of that status.

There are some small and some prominent church related schools that believe that a past or loose affiliation with the Church, Society, or Order precludes their filing. These schools may find themselves challenged by the IRS and would be wise to be proactive in their reporting.

Understanding these regulations and ensuring compliance is not an onerous or complex process. The process can be summarized in this way: full advance disclosure of the details of a transaction to a disinterested board or designated board committee; consideration of fair market value and comparability; and documentation of the decision and facts.

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