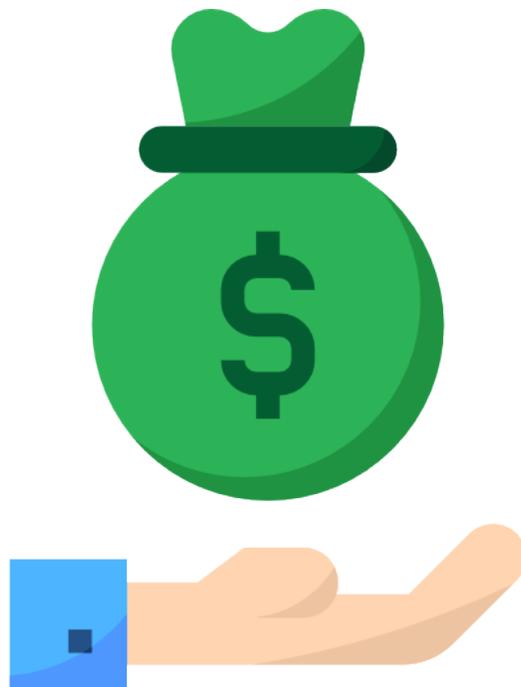




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Nonprofit Board Members To Pay or Not to Pay in 2018?



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The vast majority of boards of director members in the nonprofit sector are not paid for their services. Board members typically serve on a part-time, voluntary basis, and many in the sector feel that they should not benefit personally from their service. Most in the sector believe that directors should not receive any income, but should also not pay expenses associated with their service above and beyond their personal donations.

As a result, nonprofit board directors should not be asked to cover any debts for the organization and should not suffer personally or financially for their service. In fact, most nonprofit organizations do reimburse their board directors for organization-related expenses.

For background on setting nonprofit compensation and on the specific issue of pay for board members, there are two [ERI Economic Research Institute](#) white papers available that may be of interest:

- [What is Reasonable Nonprofit Board Pay?](#)
- [ERI Guide to Setting Nonprofit Executive Compensation](#)

Are Payments to Board Members Legal?

While board members do fall under the IRS prohibition on “self-dealing,” there is an exception made for “payment of compensation...for personal services,” which includes fees for board members. Payments, however, must be “reasonable and necessary to carry out the exempt purposes” and “not excessive.” See www.irs.gov/pub/irs-tege/governance_practices.pdf for guidance.

So the answer is yes – the practice of paying board members is permitted – but it cannot be “unreasonable” and “excessive.”

Some History

The question of paying or not paying directors is a perennial nonprofit debate. In the early 2000s, there were several newspaper reports of huge payments for trustees and some interest by the [US Senate Finance Committee](#) in limiting or even banning such compensation. The [Independent Sector](#), a group representing the interests of mostly large charities, convened a panel at the request of the Senate Finance Committee and issued a 2007 report entitled “[Principles for Good Governance](#).” There was no mention of a ban but instead a statement that “board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties.”

Many associations of nonprofits supported this position, while others, primarily [The Philanthropy Roundtable](#) (a group representing mostly large foundations) did not; the Philanthropy Roundtable continues to support the practice of compensating board members. In fact, more foundations do pay their directors than other types of nonprofits, but it is still a very small proportion of all foundations.

Reasons to Pay Board Members

- **Need to attract board members** – Some financial consideration is needed so that the prominent, professionally-credentialed individuals with the expertise needed to oversee a highly complicated organization with technical programs spanning a great variety of social problems will consider serving. If busy people with other careers give a lot of time to the nonprofit, they may need to be compensated.
- **Need to be competitive** – If the nonprofit is competing with other nonprofits and even for-profit companies for directors, compensation might be needed to attract candidates from the limited pool of potential directors. Everyone has a limited amount of time, and an offer to serve on a board that includes earnings might be the offer that is accepted.
- **More attention from the director** – Paying board members does establish a contractual obligation and an expectation of a certain amount of time and attention devoted to the work of the nonprofit.
- **Reduced incentive for personal gain** – The argument is that compensation will actually reduce the temptation to take advantage of board service for personal gain.
- **Possibility of increasing diversity** – Payment might increase the ability to recruit a more diverse board, from different cultures, economic classes, or ages – those who might not otherwise be able to serve as volunteers.
- **Incentive to take the risk of serving** – Since it is possible that legal and public relations issues might arise as a result of service on a board, prominent individuals who assume this risk of embarrassing public investigations – and perhaps even legal penalties – might require compensation.

Reasons Not to Pay Board Members

- **No need to pay** – The almost universal practice by nonprofits is uncompensated service by board members; in fact, most of the time, the money flows the other way around – financial contributions to the organizations from the board members are often typical and expected.
- **Need for committed directors** – Serving with no compensation ensures a serious commitment.

- **Compromising legal status of “volunteer” with compensation** – There is a possibility that the protective status offered in the [Volunteer Protection Act](#) could be lost if directors are paid.
- **Expectation of revenues to be spent on programs** – Donors, as well as members, clients, and users, expect their monies to be spent on services, and board members have a fiduciary responsibility to manage the organizations’ funds. Is paying themselves in the best interest of the organizational goals? Will payments to board members discourage charitable giving by those who want to see their donations used for programs?
- **Discouraging volunteering** – If board members do not volunteer, why should others? Organizations that pay board members could discourage volunteering in their programs and in their provision of services.
- **Scrutiny by charity regulators and public** – The practice of paying board members invites scrutiny from state and federal regulatory agencies, as well as criticism from the public and possible funders and donors. There is also the possibility of audits, fines, and other red tape, in addition to the loss of faith in an organization.

Research Findings on Compensation for Nonprofit Board Members from ERI’s Form 990 Data

ERI creates a database of executive compensation data from [IRS Forms 990](#), the annual reporting legally required from nonprofit organizations, used in ERI’s [Nonprofit Comparables Assessor](#). This software program calculates average competitive salary levels for the executive jobs reported on the Form 990, finding comparable organizations using the characteristics of revenue size, type of organization, and geographic location deemed relevant by the IRS when it evaluates whether income is reasonable or not.

[Nonprofit Comparables Assessor](#) users include many regulators (the IRS with multiple licenses and state charity officials) and many large nonprofits, as well as the lawyers, accountants, and consultants who serve the nonprofit sector.

To update ERI’s prior research for Form Year 2011, a new database was created that includes almost 223,000 tax-exempt organizations. Observations were taken from each organization’s most recent Form 990 for 2015, supplemented with 2014 data if the 2015 form had not yet been processed. About 76% were charitable organizations, tax-exempt under [IRC Section 501\(c\)\(3\)](#). This group is the one of most concern, as the IRS regulations dealing with compensation issues contain penalties for excessive payments for charities. Organizations given tax-exempt status under [501\(c\)\(4\)](#) add another 4% to the total of organizations covered by the excessive payments rules. Thus, about 80% of tax-exempt organizations that pay their CEOs should be aware that their salary levels for board members, as well as executives, have to pass IRS scrutiny.

The analysis in this paper focuses specifically on directors who were paid for services provided as a board member. Compensation has been defined as more than \$15,000 reported on the Form 990 – this definition was chosen to eliminate board members who receive reimbursement for expenses, so that the compensation data reflects pay for services provided as a director to the organization. The data were also reviewed to remove paid employees improperly reported as board members.

The Big Picture – Compensation for Nonprofit Board Members

Table 1 below shows all nonprofits in the 2015 ERI database reporting CEO compensation in their Forms 990 (and does not include those filing Forms 990 and 990 EZ that do not have paid staff members and the very small Form 990-N “post card” filers¹). Of the 222,716 organizations in the 2015 database, about 76% (169,119) are charities.

Of the 169,119 charities in the 2015 database, 3,168 report paying their board members – that represents about 1.9% of the charities. It is slightly more common for some types of organizations exempt under different IRC subsections to pay their directors (for example, c5 – labor and agricultural with 7.6% paying; c12 – benevolent life insurance, etc., with 14.9% paying; c15 – mutual insurance with 7.9% paying); but, these tax-exempt groups are a relatively small part of the nonprofit sector, and that is still a very small proportion of organizations paying board members. Only a small proportion of board members of all tax-exempt organizations are paid. As noted above, the IRS regulations on penalties for excessive compensation cover only organizations tax-exempt under 501(c)(3) and 501(c)(4).

Table 1. Incidence of Board Member Pay in Tax-Exempt Organizations by IRC Code, 2015

IRC Subsection for Tax-Exemption	Organization Count	Board Member Count	# Organizations with Paid Board Members	% Organizations with Paid Board Members	Paid Board Members	% Board Members Paid
3 - Charities	169,119	1,896,703	3,168	1.9	4,887	0.3
4 – Civic Leagues, Social Welfare Organizations, and Local Associations of Employees	7,943	75,515	143	1.8	247	0.3
5 – Labor, Agricultural, and Horticultural Organizations	6,873	76,351	520	7.6	1,047	1.4
6 – Business Leagues, Chambers of Commerce, Real Estate Boards, etc.	15,917	258,139	305	1.9	561	0.2
7 – Social and Recreational Clubs	6,415	58,946	48	0.7	73	0.1
8 – Fraternal Beneficiary Societies and Associations	2,802	25,691	66	2.4	123	0.5
9 – Voluntary Employee Beneficiary Associations	3,176	22,778	39	1.2	90	0.4
10 – Domestic Fraternal Societies and Associations	785	6,259	21	2.7	24	0.4
12 – Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, etc.	2,176	15,257	324	14.9	1,692	11.1
13 – Cemetery Companies	1,207	8,807	49	4.1	93	1.1
14 – State-Chartered Credit Unions, Mutual Reserve Funds	2,021	16,641	38	1.9	108	0.6
15 – Mutual Insurance Companies or Associations	101	690	8	7.9	11	1.6
Tax-Exempt – all other subsections	4,181	31,920	59	1.4	90	0.3
Total	222,716	2,493,697	4,788	2.1	9,046	0.4

¹ See www.irs.gov for information on filing requirements.

Do Larger Charities Tend to Compensate Board Members?

Table 2a below provides a more detailed look at stipends of charity board members by size. It appears that the largest reporting charitable organizations are slightly more likely to pay their board members (approaching 3% of charities). The rationale may be that larger organizations are more complex, requiring more skills and expertise from their directors, or that they might compete for board members with for-profit companies where pay is typical. Of course, these larger organizations also have more resources. However, the number of charities paying board members, regardless of size, only varies between about 2% and 3%, obviously a small minority of the charities of any size.

Table 2a. Board Member Compensation by Revenue Size for All Charities, 2015

Revenue	Organization Count	# Organizations with Paid Board Members	% Organizations with Paid Board Members	Board Member Count	Paid Board Members	% Board Members Paid
< \$500k	84,154	1,346	1.6	745,474	1,829	0.2
\$500k to \$1m	24,954	531	2.1	271,085	803	0.3
\$1m to \$5m	36,931	715	1.9	475,948	1,150	0.2
\$5m to \$10m	8,860	168	1.9	134,975	286	0.2
> \$10m	14,220	408	2.9	269,221	819	0.3
Total	169,119	3,168	1.9	1,896,703	4,887	0.3

A specific type of charity often subject to concern and sometimes public outcry about board wages is foundations. Using asset size, the most appropriate measure of size for foundations², the 8,210 organizations with paid CEOs classified as Philanthropy, Voluntarism, and Grant-making in the ERI database are grouped by size in Table 2b below. The distribution of paid board members by asset size reveals again that the overall percentage is low, but slightly higher in the largest foundations. Putting it in perspective, however, of the 1,303 foundations with assets of over \$10 million, only 28 of them pay their board members—that is 2% of the largest foundations, about twice the rate of the smaller foundations, but still a small proportion of the total. The proportion of foundations of varying sizes paying board members is typically 1% to 2%.

² See discussion at <http://philanthropy.com/article/Foundation-Trustees/147863/>.

Table 5b. Number of Charities with Paid Directors by Type and Size, 2015

NTEE Group	\$1m to \$5m	\$5m to \$10m	\$10m +
Arts	64	10	9
Education (excluding Universities)	132	43	50
Universities	7	1	22
Health (excluding Hospitals)	115	27	84
Hospitals	8	1	125
Human Services	236	52	59
Public Societal Benefit	76	20	36
All Other Charitable Organizations	77	14	23

Summary of Findings from the 2015 ERI Database

- Only 2% of all tax-exempt organizations that report paying a CEO also pay their board members.
- Charitable organizations, exempt under IRC Section 501(c)(3), represent 76% of all tax-exempt organizations and about 2% report paying their board members.
- Some organizations exempt under other IRC subsections are slightly more likely to pay their board members (for example, labor groups, life and mutual insurance companies, etc.), but the incidence of payment is still low; these organizations are not covered by IRS regulations that provide penalties for excessive compensation.
- When analyzed by annual revenues, large charitable organizations have a slightly higher incidence of payment for board members.
- Board member pay for foundations is more common for large grant-makers (measured by size of assets), but is still around 2%.
- For all other tax-exempt organizations, the incidence of pay is markedly higher for the very largest organizations, but that percentage still only rises to 14% for those with revenues of over \$10 million.
- The charitable organizations most likely to pay board members are hospitals (5.4%), followed by universities (2.7%).

Debate and controversy over the incidence and amount of wages for board members in the nonprofit sector is ongoing. IRS regulations require that, for the largest group of tax-exempt organizations, the 501(c)(3) organizations known as charities, salaries must be reasonable and based on data from comparable organizations. Based on this analysis of compensation for board members reported on the Forms 990, care must be taken to collect data that supports income for board members and stands up to IRS scrutiny.

If an Organization Does Want to Pay Directors

The organization's culture, funds, members, and donor expectations, as well as the image it wishes to portray, will all factor into the decision whether to compensate board members. The following steps would be useful if there is current payment for directors or if there is a plan to change or add payment:

- Establish policies with clear objectives and indicate how compensating the board of directors will benefit the organization.
- Determine what compensation is considered reasonable and review the compensation regularly.
- Determine which board members will be compensated (the chair, board officers, or all board members).
- Determine how the compensation will be structured (i.e., flat fee, retainer, per-diem, formula), how it will be distributed, and the tax implications.
- Determine how much each board member will be compensated and whether the chair will be paid more than others.

Careful attention to legal requirements and the details of any payment arrangements will ensure that nonprofits make informed decisions and set responsible policies for board compensation. Check with a lawyer and review [Treas. Reg. §53.4958\(b\)\(1\)\(ii\)](#) and [Treas. Reg. §53.4958-3\(c\)\(2\),\(3\)](#) for details.

Data for this whitepaper was collected by [ERI Economic Research Institute, Inc.](#) For more information, please visit www.eri.com. To download additional white papers, visit www.eri.com/whitepapers.

Please email ERI at
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