About This Form: The Justice & Diversity Center’s Community Organization Representation Project has designed the attached Executive Compensation Policy for a California Nonprofit Public Benefit Corporation. The redesigned IRS Form 990 significantly changes the reporting requirements for many tax-exempt organizations and increases the level of government oversight. Among these changes, the IRS now wants to know in more detail how your organization sets executive compensation and how much it is paying its executives. While instituting a written policy on compensation is not mandated by the IRS, such policies can improve transparency, accountability, and consistency. Instituting an appropriate executive compensation policy may also help an exempt organization avoid intermediate sanctions for excess benefits transactions. Additionally, by implementing an appropriate executive compensation policy, an organization can establish a rebuttable presumption that the compensation it pays its executive is reasonable.

Disclaimer: This Executive Compensation Policy is provided by the Justice & Diversity Center of The Bar Association of San Francisco as a public service solely for informational purposes, without any representation that it is accurate or complete. It does not constitute legal advice and should not be construed as such. It does not create an attorney-client relationship between the recipient and any other person, or an offer to create such a relationship. Consult an attorney if you have questions regarding the contents of this communication.
ARTICLE 1 – INTRODUCTION AND PURPOSE

[Name of Corporation] (the “Corporation”) seeks to establish an executive compensation policy that provides reasonable and competitive executive compensation consistent with market-based compensation practices.¹²

ARTICLE 2 – DEFINITION OF COMPENSATION

Compensation is defined as all forms of cash and noncash payments or benefits provided in exchange for services, including salary and wages, bonuses, severance payments, deferred payments, retirement benefits, fringe benefits, and other financial arrangements or transactions such as personal vehicles, meals, housing, personal and family educational benefits, below-market loans, payment of personal or family travel, entertainment, and personal use of the organization’s property. Compensation includes payments and other benefits provided to both employees and independent contractors in exchange for services.³

ARTICLE 3 – AUTHORITY TO SET COMPENSATION

The Corporation’s executive compensation policy will be administered by the compensation committee of the Board of Directors (the “Committee”).⁴ The members of the Committee will be elected by a majority vote of the Board of Directors at the annual meeting outlined in Section 5.1.

ARTICLE 4 – SCOPE OF POLICY

The Corporation’s executive compensation policy will apply to officers,⁵ directors,⁶ trustees,⁷ and key employees (“Covered Individuals”).⁸ Review of compensation for Covered Individuals

¹ The California Nonprofit Integrity Act of 2004 also sets forth the requirements for when compensation must be reviewed.
² When an organization follows the proper procedures, the IRS standard of review for challenging decisions regarding executive compensation is a rebuttable presumption of reasonableness. This is a safe-harbor procedure that can significantly minimize the risk that your organization will be liable for penalty taxes as a result of unreasonable compensation. In order to qualify for this rebuttable presumption, the organization must show that (1) the compensation structure was approved by an authorized body, (2) the compensation structure was determined to be reasonable after looking at appropriate comparability data, (3) decisions regarding compensation were adequately documented, and (4) the compensation structure was considered and approved solely by independent members who are unrelated to and not subject to the control of the person(s) involved in the compensation arrangement.
³ This definition of compensation was taken from the IRS’s Form 990.
⁴ Organizations may also decide to have the entire board set compensation rather than creating a compensation committee.
⁵ An officer, unless otherwise provided, is a person elected or appointed to manage the organization’s daily operations, such as a president, vice-president, secretary, treasurer, and, in some cases, Board Chair. The officers of an organization are determined by reference to its organizing document, bylaws, or resolutions of its governing body, or as otherwise designated consistent with state law, but at a minimum include those officers required by applicable state law. For the purposes of the Form 990, the organization’s top management official and top financial official are considered officers.
⁶ A director is defined as a member of the organization’s governing body, but only if the member has any voting rights. This definition does not include a member of an advisory board that does not exercise any governance authority over the organization.
must be performed once the Covered Individual is hired, upon any extension or renewal of the Covered Individual’s term of employment, and when the Covered Individual’s compensation is modified, unless substantially all employees are subject to the same general modification of compensation.

ARTICLE 5 – PROCEDURE

In approving and enforcing this executive compensation policy, the Committee will utilize the following process:

1. **Meetings:** The Committee will meet annually to review and approve compensation for Covered Individuals, establish any changes for the upcoming year’s executive compensation policy, and to vote on members of the Committee. The Committee may also meet as needed throughout the year to review the executive compensation policy and/or compensation for the Covered Individual, and to make recommendations for any changes to the Board of Directors.

2. **Conflicts of Interest:** The Committee will be comprised entirely of individuals who do not have a conflict of interest with respect to the Covered Individual’s compensation. If the Board of Directors is voting on compensation for Covered Individuals, interested directors shall abstain from such vote.

3. **Determination of Compensation:** The Committee will establish reasonable compensation by taking into account the amount ordinarily paid for like services by similar organizations under like circumstances.

   3.1 The Committee will collect reliable and comparable market data from similar organizations with similarly sized budgets from published surveys of similarly situated organizations, written job offers for functionally comparable positions at similar organizations, information obtained from publicly available Form 990 filings of similar organizations, and/or current compensation surveys.

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7 See footnote 4. For the purposes of the Form 990, the IRS uses the same definition for directors and trustees.
8 A “key employee” is someone who: (1) receives more than $150,000 in annual compensation from your organization and all organizations related to the organization, (2) has responsibilities, powers, or influence over the organization (or a substantial portion of your organization’s activities) that is similar to those of officers, directors, and trustees, and (3) is one of the organization’s top 20 highest paid persons for the year who satisfies both the $150,000 test and the responsibility test.
9 A conflict of interest exists when a member of the Committee: (1) is a Covered Individual participating in or economically benefitting from the compensation structure or is a member of that individual’s family, (2) receives compensation or other payments that must be approved by another Covered Individual who participates in or benefits from the compensation structure, (3) is in an employment relationship where he or she is subject to the direction or control of any Covered Individual who participates in or benefits from the compensation structure, (4) has a material financial interest affected by the compensation structure, or (5) approves a transaction providing economic benefits to a Covered Individual who participates in or benefits from the compensation structure, and who in turn has approved, or will approve, a transaction providing economic benefits to the member of the Committee.
10 See Section 4958 of the Internal Revenue Code to determine the consequences of failing to establish reasonable executive compensation.
3.2 The Committee will establish reasonable compensation based on the median of the market data collected in Section 5.3.1.

3.3 The Committee may, at its discretion, consider the Covered Individual’s background experiences, skills, and meritorious contribution in establishing reasonable compensation. The Committee may also take into consideration the availability of similar specialties in the geographic area.

3.4 The Committee may conduct periodic reassessments of a Covered Individual’s compensation based on external equity, internal equity, and/or merit.

4. **Payment:** No payment of compensation may be made until the requirements of this Article 5 are completed.

5. **Process of Appeal:** Committee decisions regarding compensation are subject to appeal before the Committee. The basis for appeal must be submitted in writing by the Covered Individual within 15 business days from the date of decision. An investigation of the basis for appeal and a final decision must then be made by the Committee within 15 business days from receiving the written basis for appeal.

**ARTICLE 6 – DOCUMENTATION**

The Committee will document the basis for the determination of reasonable compensation.

1. **Requirements:** The Committee must document the business purpose for the decision made. Such documentation will also include the terms of the compensation structure, the date of decision, the members of the Committee who were present during debate on the transaction that was approved and those who voted on it, the market data that was obtained and relied on under Section 5.3.1 and how that data was obtained, and any actions taken by a regular member of the Committee who had a conflict of interest with respect to the transaction.

2. **Timing:** All documentation must be prepared before the next meeting of the Committee or within 60 days after the date of decision, whichever occurs last. The Committee must, within a reasonable time, review, approve, and find that the documentation is reasonable, accurate, and complete.

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11 Comparability data is considered appropriate if it provides the Committee with sufficient information to determine if the compensation arrangement in its entirety is reasonable. For an organization with annual gross receipts of less than $1 million during the three prior taxable years, the IRS will consider the organization to have appropriate comparability data if it obtains data on compensation paid by at least three comparable organizations in the same or similar communities for similar services.
3. **Retention of Documentation:** Documentation used in the determination of executive compensation will be held at the Corporation’s main office for ________ year(s) from the date of decision.\(^{11}\) The documentation will be made available for review upon a reasonable request in the event that an appeal is initiated under Section 5.5.

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\(^{11}\) The documentation required by this executive compensation policy should be retained in accordance with the organization’s document retention policy and may be written or electronic.