



Can You Pay Compensation to a Board Member?

It depends. Here are some legal options.

Q:

Three of us—my husband, another person, and I—founded a 501(c)(3) organization 10 years ago. This same board is still in place. I am the secretary-treasurer; my husband is president.

I have been volunteering at least half time for these 10 years, with no compensation. I can no longer afford to do this, and our organization is finally big enough that it can pay me for all or some of my work.

Which of the following (if any) are legal options for us?

1. My husband leaves the board and is replaced with someone not related to him or me. I continue to serve as the board's secretary-treasurer. Also, I get paid as executive director. I of course would not vote on board motions regarding my own position and compensation nor sign my own paychecks. (This is our preferred option.)
2. I leave the board and am replaced by someone not related to my husband or me. My husband continues to serve on the board. I get paid as executive director.
3. Both my husband and I leave the board and are replaced by people not related to us. I get paid as executive director.
4. Same as 1, but I no longer serve as secretary-treasurer on the board.

Thank you for your help on this. We appreciate your work at the Society. Please publish this letter anonymously.

A:

Federal tax rules require that no part of a 501(c)(3) organization's net earnings may benefit any private individual. For private foundations, the rule is more specific. Any transaction involving excessive compensation paid to a board member is considered "self-dealing" and is subject to excise tax. For 501(c)(3)s other than private

foundations, this concept of self-dealing does not apply, but paying excessive compensation to directors may result in loss of the organization's tax-exempt status. To be certain of averting problems with the IRS, it is best to avoid paying compensation—even if not excessive—to board members.

Like the federal tax laws, most state laws discourage compensation for nonprofit board members. In California,

where your organization is incorporated, however, the law is more specific than most. The effect is that nonprofits in California are given more leeway than in most states. According to the relevant California provision, up to 49% of an organization's directors may be "inter-

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ested persons." Such persons include: (1) directors compensated by the corporation for full or part-time services rendered during the previous 12 months, and (2) their relatives.

None of your proposed options has more than one "interested person" as a director. Thus, all four of your options would be allowable under California law. Selection #3 would perhaps be overkill.

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None of the three directors would be an interested person, and neither you nor your husband would legally be allowed to help make policy decisions.

Selection #1, your preferred option, lets you remain on the board. Though legal, it is unusual for one individual to be a board member, officer, and executive director. The executive director is typically a full-time employee who is neither an officer nor director. Thus, #1 could result in an appearance of impropriety if something draws the attention of IRS or state officials.

Under #2 as literally described by you, you would remain secretary-treasurer although you would leave the board. In an organization such as yours, it is unusual to have officers who are not board members. Such a situation makes governance rather clumsy. Also, under this scenario, you could still be considered an interested person.

Under Option #4, your husband

would leave the board. You did not indicate whether he would remain president. If so, you would face the same

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problem as under #2—having an officer who is not a board member. If not, your problem is similar to that under #3. Both

the president and secretary-treasurer would be outside your family, and the two of you would have limited decision-making authority.

It appears that the best option is a variation of #2, with you leaving the board and resigning as secretary-treasurer. One of the other two directors, neither of whom should have any family or business connection to you or your husband, will become the new secretary-treasurer. Your husband will remain on the board and continue as president. You will be the executive director.

One word of caution. As executive director, be sure to avoid involvement in corporate policy or major decisions. Leave those matters to your husband, the board president.

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