

About That Bonus ...

Should your board give a bonus to the CEO? What factors should you consider?

Q Our board has identified a new CEO. The topic of a bonus came up during negotiation.

The board is willing to consider a bonus as part of this person's compensation package, but this is new territory for us. The directors need guidance on how to structure it. What concerns should we keep in mind?

A Bonuses are becoming more popular within the sector. They allow an organization to show appreciation to employees for a job well done without permanently affecting the budget. That's especially important because donors want their gifts to go directly to programs rather than operations so you don't want to show a high salary, yet you're competing for strong talent.

The key to any bonus program is to ensure that the bonus is tied to specific, pre-determined goals that go beyond expectations for the job. The ability to reach these goals should be under the individual's control rather than solely reliant on the work of others. Also, given today's emphasis on impact, consider crafting the goals around benefits to the community.

Here are some other things to take into account:

Bonuses should never be "a given" – otherwise, you might as well just offer the higher salary from the beginning.

Remember that bonuses must be taxed, which means the cost of offering a bonus is higher than just the dollars being paid.

Do some research to determine a "fair" amount to offer. Look at CEO bonuses in organizations similar to yours (as defined by mission category, budget size, and geographic area).

Such information is relatively easy to find. GuideStar produces annual compensation studies with both national and local data. There are also local studies (start by looking to see if your state arm of the National Council of Nonprofits produces one).

This comparison is important. It ensures that you're adequately compensating the work you value. It also shows



“The IRS does pay attention!”

that you're responsibly stewarding your organization's money and protecting all parties.

If the amount you offer is too high, you open yourselves to an excess benefit penalty. In this situation, the CEO, individual board directors, and the organization would *all* be liable for paying an excise tax that could be as high as 200% of the amount above the threshold of what is considered "reasonable."

How would the subject of excess benefit even come up? You must report bonuses on your Form 990, and the IRS does pay attention!

To ensure you don't exceed the threshold, in addition to doing your due diligence, consider setting a cap on how much money can be earned in the form of a bonus.

To help you look at this issue from all angles, consider turning the job of setting the entire compensation package, including the bonus, over to a compensation committee. Such a committee is typically made up of board directors with, perhaps, outside experts like human resources professionals, compliance officers, or attorneys who specialize in compensation.

You can find a great resource for the committee at irs.gov. It's IRS Private Letter Ruling 200601030 that spells out the process to be used for approving and awarding bonuses. While on the site, dig deep into the IRS's treasure trove of other relevant materials. Of course, you could also use a benefits consultant.

This brief response should be enough to get you started. But, remember, I'm not an attorney or tax advisor, nor do I know your organization, so this shouldn't be taken as professional advice. I suggest you speak with a labor or tax attorney or your own tax advisor before finalizing the bonus.

– Terrie Temkin, Ph.D., Founding Principal, CoreStrategies for Nonprofits, Inc., and editor of *You and Your Nonprofit Board: Advice and Practical Tips from the Field's Top Practitioners, Researchers and Provocateurs* (charitychannel.com)

Note: To assure that compensation is reasonable, see "Executive Compensation" (Vol. 23, No. 5), NonprofitWorld.org.



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