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Difficult Compensation Challenges

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Brief Summary of Intermediate Sanctions Rules (Spitzer)

- All section 501(c)(3) public charities are subject to the "intermediate sanctions" rules of section 4958 of the Internal Revenue Code.
- The intermediate sanctions rules impose penalty taxes when an organization has engaged in an "excess benefit transaction," i.e., when certain persons with a close relationship to the organization – called "disqualified persons" – receive a direct or indirect economic benefit from the organization worth more than the services or goods provided by the disqualified person in return.

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- Anyone in a position to exercise substantial influence over an organization's affairs is considered a disqualified person for these purposes.
- For example, an organization's officers, directors and trustees (as well as their close relatives and related entities) are disqualified persons.
- The excise tax penalty for engaging in an excess benefit transaction is imposed on the disqualified person and may also be imposed on any officer, director or trustee who *knowingly participated* in the transaction.

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- In addition, any managers of the organization who approved the transaction, knowing it to be excessive, may be held *personally liable* for an excise tax equal to 10% of the excess benefit, up to a maximum of \$20,000 per transaction.
- Excess benefit transactions must be disclosed on the organization's publicly-available IRS Form 990.

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- To ensure that compensation does not result in an excess benefit transaction, the "safe harbor" procedure contained in the Treasury Regulations and outlined below may be followed.
- If a board or committee has followed the safe harbor procedure to approve a compensation arrangement in advance of it being entered into, a **rebuttable presumption** is created that the compensation arrangement is not an excess benefit transaction.

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- The safe harbor procedure:
 1. Disinterested Director Approval.
 - The board or committee must determine before voting on a compensation arrangement whether any voting member of the board or committee has a direct or indirect conflict of interest with respect to the matter.
 - Any board or committee member who discloses a conflict of interest should not participate in a vote with respect to the compensation arrangement.
 - The compensation arrangement should only be voted upon by a group of board or committee members with no conflict of interest concerning the matter.

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