



Determining Reasonable Compensation for Foundation Directors and Trustees

A Guidance Memorandum from the Board of
Directors of the Council on Foundations
December 6, 2002

The Board of Directors of the Council on Foundations approved the first edition of these guidelines in June, 1989, based on recommendations from a Committee on Director and Trustee Compensation chaired by Dwight Allison.

The Council on Foundations receives numerous inquiries each year about the amount of compensation paid to directors or trustees (members of the governing board) of foundations. Since 1969, board members of private foundations have been subject to excise tax penalties for receiving unreasonable compensation.¹ In 1996, Congress passed the “intermediate sanction” rules that enable the Internal Revenue Service to apply similar penalties for excessive compensation paid by public charities.¹ In light of these legal developments and more recent public concerns about trustee compensation, the Board of Directors of the Council on Foundations has revised these guidelines to assist foundations in determining appropriate levels of compensation.

The Board of Directors of the Council is firmly opposed to excessive or unreasonable compensation. Even the public perception of excessive compensation can be damaging to the whole field of philanthropy.

In these guidelines, the Council is not addressing the practice of reimbursing directors or trustees for reasonable out-of-pocket expenses; nor are we addressing the payment of compensation to commercial entities that may serve as trustees (such as banks, law firms or trust companies). Nevertheless, these payments should be reviewed with care as well.

Differing Practices within the Foundation Community

There is a long tradition of voluntary service by members of the governing boards of charitable institutions, including many foundations. Surveys by the Council on Foundations indicate that 74.8 percent of foundations do not compensate board members.¹ Other foundations believe that a reasonable fee is appropriate. Responsible board service is time-consuming, legal requirements have become increasingly complex and potential liabilities have grown. In some cases, compensation can facilitate participation by persons with different skill levels and those with different economic circumstances.

For those foundations that do decide to compensate directors or trustees, we recommend close attention to the following information and recommended procedures:

- The law. While payment of reasonable fees is lawful, payment of excessive or unreasonable compensation violates federal and state law and can result in IRS-imposed excise taxes against participating board members.
- Ability to attract qualified persons. Is the foundation satisfied that it will be able to attract qualified board members either at the current rate of compensation (which may be zero) or at some other level of compensation?
- What is reasonable? Given the extensive diversity of foundations in asset size, spending level and complexity of programs and the different time demands required of board members, no single formula defining reasonable compensation exists. What is reasonable will depend on the facts and circumstances of each case.

Factors in Determining Reasonableness

In considering the question of reasonableness of trustee fees, each of the following factors – at a minimum – should be closely examined:

1. What functions are required and actually performed by board members?
2. What level of skill or diversity of experience is necessary to perform these functions?
3. How much time will actually be spent by each board member to complete the functions required?

¹ On page 55 of Foundation Management Series, Volume II: Governing Boards, 10th Ed., (May 2002), it states: “Less than 1 percent of community foundations reported that they compensate any board members. Most foundations that did were independent foundations. Twenty-one percent of independent foundations compensate some members and 39.4 percent compensate all members of their boards. Among private foundations (family and independent), the practice was more prevalent for larger assets groups.”

4. What is the level of compensation paid to similar board members by similar types of foundation of similar size?

Process for Determining Reasonableness

In determining reasonable director or trustee compensation, governing boards should take extra care. We strongly recommend that the process include the following steps:

1. Reliance on comparable data. The governing body should obtain and rely upon appropriate data as to comparability prior to making its determination.² Relevant information includes, but is not limited to, current compensation surveys compiled by independent firms and fees paid by similarly situated organizations for functionally comparable positions.
2. Concurrent documentation. The governing body should adequately document the basis for its determination concurrently with making that determination (within 60 days of the decision or the date of the next meeting of the governing body, whichever is later). To qualify as concurrent documentation, written or electronic records of the governing body (such as meeting minutes) should note: a) the amount of the compensation and the date approved; b) the members of the governing body who were present during the debate on the fee amount that was approved and those who voted on it; and c) the comparability data obtained and relied upon and how the data were obtained.

Compensation based on a percentage of assets

The practice of compensating individual directors or trustees by providing a fee based on a percentage of assets or income (which is utilized by a few foundations) is inconsistent with these guidelines for determining reasonableness. Percentage fees for individual board members provide much greater potential for excessive compensation and should be avoided.

Fees for specific services

In addition to the normal “core duties” of a foundation board such as setting overall policy, approving grants and overseeing investment management, some directors and trustees provide specific services for which they receive a professional fee (for example, brokerage fees, legal fees or accounting/auditing fees).³ Such arrangements can lead to fees that are excessive. The use of outside, or third party, professionals for paid services is preferable. If, however, board members are paid fees for professional services, the foundation should adopt and implement the so-called “rebuttable presumption” procedures set forth in the Treasury regulations that

² See footnote #3.

³ When a nonprofit organization retains a board member to provide professional services, there exists by definition a conflict of interest under state law. While such conflicts *per se* are not normally illegal, the board needs to follow specific legal procedures for approving such a payment to avoid a state law violation.

implement the intermediate sanction rules applicable to community foundations and other public charities.⁴

At the time of this memorandum, the opportunity to take advantage of the rebuttable presumption procedures was available only to public charities under the intermediate sanction rules. Public charities and their governing boards are not *required* to take these steps; rather it is an option with attractive benefits if done correctly. The IRS, however, is currently reviewing whether or not to amend the private foundation regulations, to provide a similar rebuttable presumption option under the self-dealing rules.⁵ Thus, while technically not applicable to private foundations, these steps are strongly recommended as a “best practice” for all foundations.

If public charities follow these procedures, the amount of compensation is presumed to be reasonable and the burden of proof shifts to the IRS to prove the contrary (rebut the presumption of reasonableness). The three basic steps required are:

1. The approval of the level of compensation must be made by the governing board with no participation by the board member to be compensated.
2. The governing body must obtain and rely upon appropriate data as to comparability and reasonableness of fees prior to making its determination.
3. The governing body must adequately document the basis for its determination concurrently with making that determination (within 60 days of the decision or the date of the next meeting of the governing body, whichever is later).

For more detailed discussion of these rebuttable presumption rules, see the Council’s Guidance Memorandum on *Recommended Best Practices in Determining Reasonable Executive Compensation*.

Note: It is recommended that foundations consult with experienced legal counsel for more detailed advice. Any questions with regard to this memorandum may be directed to the Legal Department at the Council on Foundations by email (legal@cof.org) or telephone (703-879-0600)

⁴ The rules are spelled out in Treasury Regulation Section 53.4958-6T

⁵ Announcement 2000-47, Internal Revenue Bulletin, 2002-18 (May 6, 2002).