COMPENSATION AND BENEFITS

NONPROFITS' EMPLOYEE COMPENSATION AND BENEFITS FACE CLOSER SCRUTINY AFTER TCJA

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Nonprofit organizations should consider taking certain actions in response to the greater scrutiny of their compensation and benefits policies caused by the Tax Cuts and Jobs Act.

[pg. 27]

As the economic environment becomes more competitive, nonprofit organizations (NFPs) must position themselves to attract the best employees. Additionally, they must offer valuable and creative incentives to retain the talented workforce they have in place. Although monetary incentives make a difference, value does not always equate to money. Nonprofits have an opportunity to leverage their mission, brand and creative benefits to entice leading talent to pursue their career in a nonprofit environment. With a strong mission in place, and the incorporation of human resources best practices, nonprofit organizations can hire the best and brightest for their team.

However, as a result of the recent Tax Cuts and Jobs Act (TCJA), **1** a substantial number of *for-profit* companies not only provided a one-time bonus, but were also quick to act and announced increases to:

- Minimum wage
- Salaries

- Retirement benefits
- Investment in training employees

NFPs were already faced with challenges in competing with their for-profit counterparts, and the TCJA changes did not help close the difference. NFPs may have to take an even more critical look at their offerings and proactively address this issue, as they now face a 21% excise tax on compensation over $1 million made to any of its five highest-paid employees during the tax year. This also includes "parachute payments" to departing employees. Certain positions are excluded if they perform services directly related to their expertise (for example, a physician providing medical services at a clinic). **2**

At least 118 nonprofit chief executives earned more than $1 million in 2014 or 2015. A recent *Wall Street Journal* analysis identified 2,700 nonprofit executives who made seven figures in 2014, including investment managers, college coaches, and surgeons. More than half of the nonprofit institutions that paid at least $1 million to their top official in 2014 or 2015 were hospitals or medical centers. **3**

At a time when more Americans are facing rising medical bills and tuition costs, hospitals and colleges are paying their executives larger salaries. The attempt to level the playing field while still seeking donations and public support (as they are NFPs) will create a difficult balancing act.

What will the scrutiny mean?

[pg. 28]

The impact of the TCJA will result in a hot magnifying glass review of NFPs, especially of their spending for compensation and benefits (Total Compensation). NFPs will have to improve their disclosure policies to fully disclose the Total Compensation offerings through a similar approach to that of public companies: the use of a Compensation and Discussion Analysis, which articulates the specific components of executive compensation, including the details around the Total Compensation Philosophy and the types of individuals needed to effectively run their organizations. This may be very new for most organizations but the external examination will require this approach. Questions should involve such matters as:

- *Peer group definition.* Which entities does the NFP compete with for executive talent both in the for-profit and NFP sectors?
- *Competitive positioning.* How does an NFP performance compare to its peers and how is performance going to be determined?
- *What types of benefits are payable in the future?* Unlike their for-profit counterparts, NFPs are only required to disclose compensation that is paid currently and included in W-2 compensation. As such, payments from **Section 457** -type plans (especially the **Section 457(f)** plans) are not disclosed until they are paid, and this causes questions as to the large amount paid. Disclosing, in supplemental disclosures, these types of plans and how much has been earned, will assist in countering the public outcry when it is paid and the size of the

potential excise tax that is due at that time.

- *IRS rebuttable presumption.* NFPs are required currently to perform certain procedures to be in compliance with the IRS regulations, including having independent board members or committees review and approve executive compensation prior to it being earned, citing Peer Group Data that is used, and relying upon independent consultants to assist in this process. This would be an ideal place to expand upon this information and defend Total Compensation programs.

[pg. 29]

The scrutiny may also extend to disclosing how the NFPs will pay for the **Section 4960** excise tax. For example, suppose Employee A of University X earned $11 million per year. The organization is liable for a $2.1 million excise tax. Will University X disclose the internal resources used to pay for this liability? Will this result in budget cuts to pay it?

Conclusion-how should NFPs react to the TCJA?

The above-noted changes, along with for-profit companies announcing their plans for using their TCJA tax savings for benefits, will also have a trickle-down impact on the entire NFP-not just the top paid individuals. NFPs had difficulty competing before, so what should they do now?

- *Create or update Total Compensation Philosophy.* This is an NFP's blue-print for Total Compensation Offerings and is in fact a strategic plan for its people. This will be the answer to not only the how, but the why.
- *Review Total Compensation offerings.* The objective is to not compete head-on with salaries and bonuses. Alternately, developing more attractive options surrounding non-salary related opportunities, such as paid time off (PTO), schedule flexibility, low-cost benefits, and life-style total compensation packages, should be addressed.
- *Develop alternate retirement plan strategies.* The goals of these changes is to provide higher contribution rates for longer-tenured employees vs. providing the same level for all employees.
- *Refine strategy of across-the-board compensation increases.* With limited compensation budgets, considering the benefits of providing a more merit-based system vs. across-the-board increases may be of value.
- *Retention bonus plans.* Although retention bonus plans have historically been viewed as a giveaway, NFPs may consider the benefits of this strategy, including some type of longer-term retention component (e.g., 50% of the otherwise payable bonus would be deferred until retirement or some other future event).
- *Revamp communications.* This is the time for NFPs to be more transparent with pay practices for its employees and external stakeholders. This will aid in gaining public understanding and force a focus on why a NFP must provide certain Total Compensation packages.

1 P.L. 115-97, 12/22/17.

2 Section 4960 . See Nitsche, " **Section 4960** : New Excise Tax on Excessive Compensation," 29 Taxation of Exempts 3 (May/June 2018).

3 Fuller, "Charity Officials Are Increasingly Receiving Million-Dollar Paydays," Wall Street Journal, 3/6/17.