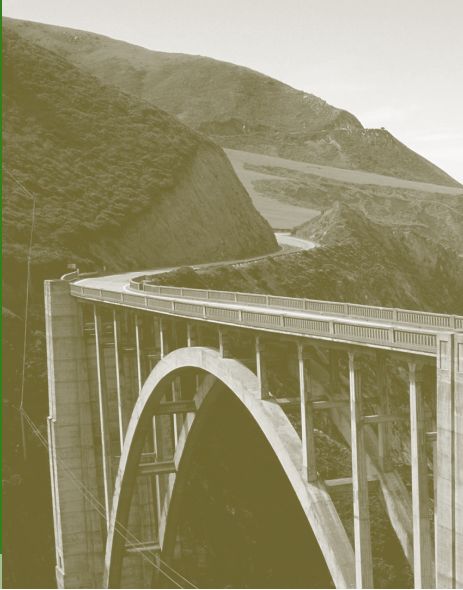


Board Compensation: Reasonable and Necessary?

PASSAGES

EXPLORING KEY ISSUES IN FAMILY GIVING

VOL 3.1



Deciding whether to compensate or reimburse family foundation board members can be a difficult and complex decision. Boards and foundation observers have long debated the reasons for and against compensation and reimbursement. This *Passages* essay discusses the difference between compensation and reimbursement, provides guidance on how to initiate a conversation among your board members about whether or not compensation is appropriate, and offers suggestions for how to develop a written policy based on this conver-

sation. While these suggestions are aimed primarily at the boards of private and family foundations, they may be appropriate to other types of grantmakers, including supporting organizations and, in some cases, donor-advised funds.

COMPENSATION OR REIMBURSEMENT?

Compensation generally refers to fees paid to an individual for their service on the board, as well as fees that board members may receive in exchange for providing “professional” services to the foundation—including legal, accounting, and other necessary activities for accomplishing the foundation’s mission. Reimbursement refers to payment for expenses that board members incur while attending foundation meetings, site visits, and other activities. Depending on where a trustee lives, how often the board meets, and what other responsibilities trustees are asked to take on, these expenses can range from a very small amount to thousands of dollars per year.

While most family foundations do not compensate their trustees, many have determined that reimbursement of expenses is appropriate and necessary. A recent Council on Foundations study found that less than one-quarter of the Council’s family foundation membership provided compensation for board service. This same study found that

more than half of the foundations surveyed reimbursed at least some of their board member’s expenses. (See *Trends* in the “Additional Resources” section below for more information on this study).

How do you determine whether board compensation makes sense for your foundation? The remainder of this paper addresses the basic considerations in this decision, and provides suggestions for how to go about developing or revising your own policy. Related to board compensation is the question of reimbursing expenses. Many foundations view the question of whether or not to reimburse expenses quite differently than that of compensation—see the box on page two for considerations related to establishing a reimbursement policy.

WHAT THE LAW SAYS

Family foundation trustees are classified as disqualified persons, and as such are subject to special rules regulating self-dealing and “conflict of interest” in private foundations. For purposes of this essay, we refer to the governing boards of foundations as



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“trustees.” Please note, however, that there are different legal responsibilities imposed upon governing boards depending on whether they are formed as a corporation or a charitable trust—refer to the additional resources listed on page six for more details.

Disqualified persons include substantial contributors and all family members of substantial contributors. “Substantial contributors” are all individuals who have contributed more than \$5,000 to the foundation, where that contribution represents more than two percent of the gifts received by the foundation at the time of the gift. Thus, anyone related to the founder of the foundation is almost assured of being considered a disqualified person. Compensating, paying, or reimbursing the expenses of a disqualified person is viewed as self-dealing, and may be subject to significant fines for both the foundation and the individual trustees.

However, the law contains an important exception to this self-dealing rule. This exception allows payments to disqualified persons (other than payments to a government official), provided that these payments are for personal services that are reasonable and necessary to carrying out the exempt purposes of the foundation.

WHAT THE LAW MEANS

The law’s basic intent is to keep family foundation donors and boards from compensating family members and other disqualified persons at levels that are higher than appropriate for the services they provide. The law does not specify what “reasonable and necessary” services and compensation may be, but there are a number of considerations and sources to refer to when thinking about these issues (see “Developing or Reviewing a Compensation Policy,” below for more details).

Many foundations and trustees, reflecting upon the nature of foundation board service more generally, follow a strict interpretation of the law’s intent. This view holds that private foundations exist in order to fund nonprofits. Ensuring that funds are used primarily for this purpose is the law’s clear intent. Thus, only in very special cases should a foundation consider compensation or reimbursement.

For more information on the legal guidelines regarding compensation and reimbursement, see the resources listed on page six.

PREPARING FOR A BOARD CONVERSATION ON COMPENSATION

It is important to have the conversation about whether your foundation will provide board compensation before it becomes a difficult or pressing issue. Having clear guidelines and an understanding among both current and future board members, ideally while the founder is still actively involved, can save a foundation from many difficult conversations.

There are several factors that will help the board determine whether compensation or reimbursement is appropriate to their circumstances. If one or more of the founders are active in the work of the foundation, or have provided specific guidance on this issue, the board may have a simple answer to their questions. Otherwise, board members will want to review their own service to the foundation, their basic philosophy on that service, and other important management, grantmaking, and family questions.

Prior to having a full board discussion on this issue, consider distributing a list of key questions to board members to help them think about their own views on this subject. The following is a sample of these types of questions:

Expense Reimbursement:

CONSIDERATIONS AND OPTIONS

Legally, the IRS views trustee compensation and expense reimbursement in the same light. For both, the key question is whether paying expenses (or compensation) is reasonable and necessary to carrying out the exempt purposes of the foundation. Still, many argue that expense reimbursement is inherently more reasonable. Here are some questions to help you think about whether expense reimbursement is appropriate to your foundation:

- What are the founding donors’ opinions on expense reimbursement? What are the family’s values regarding voluntary
- boards? Are they reimbursed for the expenses of other voluntary board service?
- Is our philosophy on the issue of reimbursement consistent with what we expect of trustees in terms of their board service? Do we take into account the expense associated with site visits, meetings, and other board activities when deciding on what level of commitment is appropriate and necessary for continued board membership?
- Have we kept accurate and complete records regarding the amount of expenses contributed by board members
- in the past? Do we wish to keep these records in the future?
- What are typical expenses incurred by individual trustees? Are circumstances different for individual trustees? Do trustees have different abilities to cover their own expenses and take time off from other life responsibilities for foundation service? Is payment of expenses necessary for an individual trustee’s continued participation?
- Are there ways that we can reduce the ongoing expenses of our board members (conference calls, use of email, choice of meeting location, etc.)?

Founder's Guidance

- Are the founding donors currently on the board or otherwise active in the foundation? If so, what are their opinions on the question of board compensation?
- If the founders are no longer active, what were their purposes in establishing the foundation? Did they intend that trustees of the foundation be paid for their service? Did the founders ever receive compensation for their service?
- Are there specific instructions in the bylaws, articles of incorporation, or other governing documents related to this issue?

Board Philosophy

- What is our own philosophy on nonprofit board service? Are we volunteers lending our expertise and knowledge to the governance and management process? Or are we “professionals” who should be compensated for lending our expertise and knowledge to this process?
- How do other foundations of our size and presence in the community approach this issue? What would we expect others in our position to do?
- Have we discussed this matter with key grantees of the foundation? Do any of them have a policy on board compensation?

Board Service

- Do we as trustees, in addition to our governance roles, also perform services that are commonly considered “professional” or “managerial” positions—such as managing investments, providing legal or accounting services, supervising staff, sending out regular mailings, and other activities? Is this spread equally among all of the trustees, or the responsibility of one or two of the trustees?
- Is our philosophy on the issue of compensation consistent with what we expect of trustees in terms of their board service? Do we take into account the time associated with site visits, meetings, and other board activities when deciding on what level of commitment is appropriate and necessary for continued board membership?
- Have we kept accurate and complete records regarding the amount of time contributed by board members in the past? Do we wish to keep these records in the future?
- How many proposals received each year are not funded due to a lack of grantmaking funds available? Would significantly more grantmaking funds be available if trustees were not compensated/reimbursed?

Family Participation

- Is payment of compensation for service necessary for an individual trustee's continued participation? Will this have an impact on family branch participation in the foundation?
- If there are younger family members on the board, should they be treated differently? Should there be compensation for

these individuals while they are in school? Should this end/ be phased out once they get jobs?

- Is paying compensation to some trustees but not others likely to cause divisiveness within the family?
- Is there a tradition or system within the family regarding family branch participation in the foundation? Is membership on the board viewed as a privilege in and of itself, and might providing compensation raise issues of fairness within the family?
- What are the family's values regarding voluntary boards? How can these be best reflected in a compensation policy?

Having clear guidelines and an understanding among both current and future board members, ideally while the founder is still actively involved, can save a foundation from many difficult conversations.

HAVING THE CONVERSATION

After getting the board to agree to a conversation on the topic of board compensation, add the issue as an agenda item for one of your upcoming meetings, with a set amount of time to discuss the issue. Prepare the board for this discussion by sending out a list of questions similar to those above. Develop ground rules for the discussion, and make sure that all members are provided with equal time to make their case. If, after having this initial discussion, the board would like to pursue the possibility of compensating some or all of its trustees, suggest that this issue be re-considered at the next board meeting, after you have collected the information needed to establish a specific board compensation policy.

For more information on how to have a successful board meeting, refer to the National Center's *Passages* white paper, “Family Meetings: Preparing for an Effective Family Foundation Discussion” (full text available at www.ncfp.org), or see the *Family Foundation Retreat Guide*, by Alice Buhl and Judy Healey.

DEVELOPING OR REVIEWING A COMPENSATION AND REIMBURSEMENT POLICY

If your foundation decides that providing compensation and/or reimbursement for trustees is necessary, it should develop a specific policy addressing the following issues. Although such a policy does not guarantee that you have complied with the IRS's “reasonable and necessary” guidelines, it should provide

your board with a clear understanding of when they will be compensated or reimbursed, and when they will not.

How was the policy developed?

Include a short description of the rationale for your policy. This may include a combination of any or all of the following:

- Reviewing printed materials and surveys on the subject
- Conducting a survey of other similar organizations
- Contacting associations of foundations or nonprofits for information on this issue
- Reviewing actual out-of-pocket expenses of trustees, and
- Reviewing fees paid for similar services for other similar organizations.

Is there a position description for board members?

Create a position description for board members and/or family staff that specifies the duties and skills needed to perform the functions of the position. This helps the foundation justify the compensation level they set. Position descriptions are also useful in training new board members for their responsibilities, and helping the board hold itself accountable for its own service.

What will compensation be based upon?

If compensation is to be provided, state clearly whether it will be paid on an annual, per meeting, or some other basis, and on what basis the amount was determined. The policy should state that each trustee is responsible for submitting an annual report documenting time spent on foundation activities (while not legally required, such a report could prove very helpful for audit purposes). The policy should also state specifically that this compensation must be reasonable for the services provided, and necessary for the effective operation of the foundation.

What expenses will be reimbursed, and what are the limits on these expenses?

Examples might include, “Coach airfare for each trustee of up to \$600 per board meeting will be reimbursed by the foundation,” or “Hotel accommodations of up to \$150 per night will be reimbursed for the night before and immediately after the board meeting only.” Again, being specific about these limits will minimize misunderstandings and disagreements over time.

What expenses will not be reimbursed by the foundation?

This might include meals, dry cleaning, entertainment, and other expenses. You may also agree to cover some key expenses—such as airfare—but not other expenses, such as hotel rooms. What’s the harm in staying with Aunt Millie for a couple of days each year around the Board meeting?

Who decides what level of compensation to provide and approves requests for reimbursement?

Whether this is the board chair, a committee of the board, or one or more outside advisors to the foundation, the policy should identify who will make these decisions. Using outside

Create a **position description**
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advisors may help to avoid family resentments in situations where board members are compensated differently. This person/committee will also help ensure that compensation and reimbursement are budgeted and tracked appropriately.

ALTERNATIVES TO COMPENSATION

If your board decides that providing direct compensation for board service is not appropriate or desired, you may still want to consider instituting one or more of the following alternatives to honor and encourage their ongoing service:

- **Discretionary grants:** some foundations allow their trustees to make a small number of discretionary grants to nonprofits of their choice, most often within the foundation’s stated guidelines (another option is to provide a small discretionary grants budget to each trustee).
- **Matching grants:** these grants are usually made in recognition of an individual board member’s personal gift to a nonprofit, where the foundation matches the gift according to some predetermined formula (often one-to-one) up to a certain amount each year.
- **Supporting outside voluntary board service:** some foundations encourage the service of their board members on other voluntary boards by agreeing to make an annual gift (perhaps \$500 or \$1,000) in honor of that service.
- **Supporting outside family members’ involvement:** another option is to consider reimbursing the travel of a spouse or children of the board member to attend board meetings or educational conferences. This type of benefit must be treated as compensation, but again can be a nice way of encouraging participation by the extended family in the activities of the foundation.

Please note that in each of the above instances the full board is legally responsible for approving the grants and ensuring that recipients are eligible grantees. Still, these alternatives encourage foundation trustees to continue to develop and support their own causes and interests, and send a clear message that the foundation values highly the individual’s time and commitment to the nonprofit sector at large.

Thoughts

FROM YOUR COLLEAGUES ON TRUSTEE COMPENSATION

“Following the policy of many American foundations and most nonprofits, the family decided that no member of the board, or officer of the board, would be compensated. Trustees would be reimbursed for the expenses of attending a meeting, but would not receive salaries for their work. Even the modest honoraria offered for board service by some foundations was not acceptable. For the Cummings family, payment was incompatible with managing a public trust.”

—**from *A FAMILY FOUNDATION: LOOKING TO THE FUTURE, HONORING THE PAST* (A history of the Nathan Cummings Foundation)**

“You want trustees and directors that share the values and goals of your foundation. This requires that your board is clear about its mission and culture. Your policies should [also] model the behavior you hope to see in your grantees. If you pay your directors, be prepared to support the same in your grants.”

—**KARL STAUBER**

President, Northwest Area Foundation

“I know that many foundations choose not to pay fees to trustees, and I respect that. But from the perspective of a younger

family member who joined the board while I was in graduate school, paying fees helped a lot. Being on the board is wonderful, but it’s a significant time commitment.”

—**ANONYMOUS TRUSTEE**

“Once compensation is in place, it’s very difficult to remove. The board must discuss and decide why or why not. If compensation is approved, the rationale should be clearly written down as foundation policy to protect the board members and the foundation from the appearance of self-dealing.”

—**MARLENE FLUHARTY**

Executive Director, Americana Foundation

“It’s tricky deciding what’s fair compensation when some branches of a family are wealthier than others. What are the psychological repercussions of having a non-uniform policy in which only certain cousins are compensated for their board service? Will they feel like charity cases? Will the other board members begin to resent not being paid? Families have to know one another well to have a policy that is not uniform.”

—**DEANNE STONE**

author and researcher on family foundations and businesses

REASONS FOUNDATIONS MAY WANT TO COMPENSATE BOARD MEMBERS

- To encourage younger family members and branches of the family that are less financially secure to participate on an ongoing basis
- To recognize extraordinary service and commitment of individual trustees
- To encourage non-family members (experts, lower-income individuals, or community representatives) to serve on the board
- To encourage all board members to treat their roles and responsibilities seriously and to participate on a regular basis
- To attract committed and experienced family and non-family members to the board
- To promote the understanding that all board members are expected to provide staffing and management services for the foundation

REASONS FOUNDATIONS MAY NOT WANT TO COMPENSATE BOARD MEMBERS

- Serving on a family foundation board is a privilege that very few individuals—and few family members—are allowed to have
- Goes against the founder’s wishes for the foundation
- May put the foundation in an unfavorable light within its community
- Goes against the concept that foundations are voluntary charitable institutions serving the public trust, and that board service on a foundation should thus be viewed as volunteer service
- Takes away from the amount that can be distributed annually in grants
- Requires that accurate and complete records are kept of time spent and expenses incurred
- Increases chance of increased governmental oversight of the foundation and the field
- May cause divisiveness within the family: board service may already be viewed as a role of privilege and/or power and compensation may add to that tension. Family members may become dependent on the compensation as a source of income, jeopardizing effectiveness of their service and board rotation policies.

CONCLUSION

The issue of trustee compensation has legal and ethical implications, and may well have implications for the future of the field. Legally, trustees of family foundations are often eligible for compensation, provided that it is for services that are necessary to the charitable operations of the foundation, and that the amount is reasonable for the services provided. If you decide that this is the case for your foundation, it is extremely important that your board work with its legal advisors to develop a clear policy on compensation (and reimbursement), and that individual trustees keep careful record of the time spent and services provided to the foundation.

Ethically, trustees of family foundations should think carefully about whether compensation is appropriate for some, all, or none of the trustees of their foundation. The values of the foundation should guide decision making about such important and sensitive issues. The discussion questions provided at various points in this paper will help the board to think about these issues, and to come to a decision on what policy is most appropriate. You may also want to consider using one or more of the alternatives to compensation discussed above.

Finally, boards of family philanthropies may wish to consider the implications of trustee compensation, both for their own foundations, and for the field at large. How do they hope their foundation is viewed by their colleagues in the grantmaking community? By the grantees and nonprofit institutions that they support now, and in the future? And how will trustee compensation be viewed in Congress in the short- and long-term as it makes decisions about the roles of private foundations in U.S. society?

These and other important questions should be considered as foundations establish and revise policies regarding trustee compensation.

by Jason Born

ADDITIONAL RESOURCES ON TRUSTEE COMPENSATION AND EXPENSE REIMBURSEMENT

- “Avoiding Conflicts of Interest and Self-Dealing,” by Benjamin T. White, Chapter IV, *Investment Issues for Family Funds*, National Center for Family Philanthropy, Vol. 2, 1999. To order, go to: www.ncfp.org.
- “Conflicted Over Compensation,” by Kent Allen, *Foundation News and Commentary*, January/February 2001, pgs. 24 – 27.
- “A Dubious Legacy,” by Lee Draper, *Foundation News and Commentary*, March/April 2001, pgs. 22 – 25.
- “Everything You Ever Wanted to Know About Compensation... But Were Afraid to Ask,” by Richard Speizman and V. Moore, *Philanthropy*, 2000. To view full document, go to: www.philanthropy.org.
- *Family Foundation Retreat Guide*, by Alice Buhl and Judy Healey, Council on Foundations, 1995. To order, go to: www.cof.org.
- *Family Meetings: Preparing for an Effective Family Foundation Discussion*, by Jason C. Born, *Passages* Essay series, National Center for Family Philanthropy, 2000. To order or view full document, go to: www.ncfp.org.
- *Grantmaking with a Compass: The Challenges of Geography*, by Deanne Stone, National Center for Family Philanthropy, 1999. To order or view an excerpt, go to: www.ncfp.org.
- “Should the Independent Voluntary Sector Become the Independent Paid Sector,” *Foundation News and Commentary*, Jan/Feb 1997, p. 48.
- “The Rules Against Self-Dealing,” by John A. Edie, Chapter VIII, *Family Foundations & The Law*, Council on Foundations, 1999. To order, go to: www.cof.org.
- “To Pay, or Not to Pay,” *Foundation News and Commentary*, Mar/Apr 1998, p. 52.
- *Trends in Family Foundation Governance, Management, and Staffing*, Vol. III, by Jason C. Born, Council on Foundations, 1999. To order, go to: www.cof.org.

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For more information on the National Center's resources for family giving please call:
Brian C. McMaster

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The National Center for Family Philanthropy, a nonprofit 501(c)(3) organization, encourages families and individuals to create and sustain their philanthropic missions. In doing so, we are guided by a set of values and principles that reflect our own understanding of the opportunity, character, and contributions of family philanthropy. These values include:

- We value the participation of individuals and families in private, organized philanthropy.
- We value the donor's right and ability to direct charitable assets through the philanthropic vehicles and to programs of choice.
- We value the personal acts of generosity that inspire private philanthropy, respecting both the issues of privacy and public trust that attend the decision to give.
- We value the pursuit of excellence in philanthropy.
- We value the role that philanthropy and philanthropic citizenship plays in a civil society.
- We value the participation of new voices in our field
- We value collaboration and respect our colleagues in this work.

A full statement of these values and guiding principles as well as a description of our programs and services is available on our website at www.ncfp.org.