NONPROFIT ORGANIZATIONS

Update

SUMMER 2008

Does Your Organization Need A Compensation Committee?

With all of the recent attention on the governance of nonprofit organizations, some nonprofit boards have been reconsidering how they set compensation for the organization's executive staff.

A committee dedicated to reviewing and setting compensation can help the board to focus on this responsibility and ensure that the organization's compensation program is reasonable and meets the expectations of the government and the organization's members or donors.

Intermediate Sanctions Safe Harbor

Organizations that are tax-exempt under Internal Revenue Code (IRC) Sections 501(c)(3) or (c)(4) have an additional challenge. Those organizations can be subject to intermediate sanctions under IRC Section 4958 in the form of excise taxes if the IRS determines that any compensation arrangements for the staff or board results in private inurement. To take advantage of the rebuttable presumption safe harbor provided by the IRS, organizations should ensure that their compensation arrangements are: 1) reviewed and approved by the board of directors or a committee authorized by the board; 2) supported by appropriate data as to comparable compensation; and 3) documented with a contemporaneous record.

What is a Compensation Committee?

Typically, the full board will decide on the salary and benefits of the senior staff or charge the executive committee with reviewing and setting compensation. However, with the increased scrutiny by government agencies and donors and the increased complexity of some benefit programs, a compensation committee may be useful. A compensation committee can ensure that the board fulfills its fiduciary obligations in establishing and overseeing a compensation program.

A compensation committee is usually a small committee that is tasked with setting the policies for total compensation of the staff and then reviewing and setting compensation on an annual basis. Unlike an executive committee or finance committee that has other duties to perform, the attention of the compensation committee is focused solely on compensation issues. This gives the committee members the opportunity to learn more about this complex issue and to develop relationships with the consultants who help them fulfill their charge.

continued next page

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IN THIS ISSUE

If you have any suggestions about topics you'd like to see addressed in future issues, please contact Editor Mary Claire Chesshire at mchesshire@wtplaw.com. We look forward to hearing from you.

The compensation committee may be given the authority to set compensation or it may act in an advisory capacity, with the full board making the ultimate compensation decisions.

Composition of the Compensation Committee

Most compensation committees are small and comprised of disinterested board members (those who do not receive compensation – directly or indirectly – from the organization). Staff should not serve on the compensation committee, but may assist the committee in working with outside consultants. Because the compensation committee may work with the audit committee, the chair of the audit committee should not sit on the compensation committee. This gives the audit committee impartiality when reviewing the administration of the compensation program.

Compensation committee members should understand compensation, the complexity of employee benefits, and the need for independent analysis and advice about executive compensation.

Charge to the Committee

In smaller organizations, the compensation committee may set the compensation ranges for all employees. More often, the committee approves compensation ranges for executive staff only and the board authorizes the chief executive officer to handle compensation for the rest of the staff. Some organizations have the compensation committee review only the salary and benefits package for the chief executive officer (the executive director or president). A better practice is to have the compensation committee review the compensation of all senior staff. In rare cases, the president or executive director may not be the highest paid staff member of the organization.

If the compensation committee sets the compensation ranges for staff, the CEO should set the actual compensation paid to staff. This preserves the distinction between the oversight provided by the board and the management of the organization by the CEO.

Review Total Compensation

The compensation committee should consider all elements of the compensation package, salary, and benefits. Attention should be paid to any benefits that are only available to executives or the CEO. The committee should work with a consultant who can assist them in benchmarking salary, and benefits based on the geographic area, compensation at similar organizations, and the staff's level of responsibility and experience. In addition to a compensation consultant, the committee should work with an employee benefits specialist to ensure that the organization's benefit plans do not fail discrimination testing by providing favorable benefits to senior staff.

Reporting Back to the Board

The compensation committee should report to the board whenever it sets or changes compensation. Sometimes concerns about maintaining confidentiality prevent board leadership from sharing compensation information with their fellow board members. While their concerns may be understandable, this is not a good practice. The board members should be informed of the need to keep compensation information confidential and their fiduciary obligation to act in the best interest of the organization. Then they should be given information on the compensation the organization pays to its senior staff and trusted to act appropriately.

Conclusion

A compensation committee may not be right for every organization. The use of a compensation committee should be evaluated in connection with the organization's entire committee structure and how the compensation function is currently handled. If the organization is struggling with how to set and oversee compensation, a compensation committee might be just what the organization needs to get this important board duty under control.

Eileen Morgan Johnson

Pension Protection Act Revisions

The Pension Protection Act (PPA) of 2006 passed legislation that affected many types of nonprofit organizations, in particular certain 501(c) organizations known as supporting organizations and their supported organizations.

Supporting organizations are defined as tax-exempt charitable organizations organized and operated exclusively to fulfill the purpose of one or more public charities — their supported organizations. The relationship between the supporting and supported organization is one that involves financial support by the supporting organization. A familiar example of a supporting organization is a charitable nonprofit arm of a nonprofit health care system whose sole purpose is to fund various nonprofit hospitals within the system. Supported organizations may be public charities as well as certain noncharitable organizations, such as social welfare or civic leagues. The conduct and activities of a supporting organization are closely monitored by its supported organizations. It is required that the supported organization be either a parent or subsidiary of its supporting organization, or the organizations share board members or that other elected officers; the supporting organization may also operate in connection with its supported organization so that the supported organization's needs are responded to and their interests are effectuated by their supporting organization.

The changes to the Internal Revenue Code made by the PPA in 2006 were intended to put an end to the abusive practice of having donations made to a supporting organization channeled to either the donor or a person or organization related to the donor. The legislation involved new sections of the Internal Revenue Code that imposed an excise tax on certain funding relationships between supporting organizations and what Congress calls 'disqualified persons.' These transactions, known as 'excess benefit transactions,' occur when the supporting organization makes payments or distributes funds that benefit a substantial contributor or other disqualified person who provides a benefit or contribution of lesser value to the supporting organization than that which they receive.

Within the first year of enactment, it was clear to Congress that many legitimate funding relationships between 501(c) supporting and supported organizations were inadvertently falling under the rubric of an excess benefit transaction, subject to excise tax due to the 2006 PPA legislation. The 2006 PPA legislation failed to carve out an exception that would allow all nonprofit supporting organizations to make payments and grants to other nonprofit organizations that had been permitted prior to the 2006 legislation. The effect of Congress's oversight was to penalize the funding by one arm of a charitable organization to other arms of the charitable organization, even though the funding or lending relationship was long-standing and perfectly legitimate.

Congress recognized that the technical language of the PPA failed to exclude certain 501(c) organizations from the excess benefit transaction rules and that these particular organizations, such as social welfare organizations and business leagues, and their contributors were not intended to be reached by the excise tax. To remedy the overly broad language in the Internal Revenue Code, Congress included legislation in the Technical Corrections Act of 2007 to ameliorate the fact that the language of the PPA imposed excise tax on legitimate charitable gifts by a supporting organization to supported organizations authorized by the Internal Revenue Service specifically to enable the supporting organization to fund its exempt organizations. The 2007 Act inserted new language into the Internal Revenue Code that allows all supported organizations to maintain a funding relationship with their supporting organization in which the supported organization is still eligible to receive funding, payments, or loans from its supporting organization even when the recipient of the funds is closely related to the supported organization.

The new provision applies retroactively to August 17, 2006, the effective date of the PPA.

Allison Wettlaufer

Beware of Cybersquatting and Other Domain Name Abuse

This article first appeared in the April 2008 edition of Associations Now, a publication of ASAE and the Center for Association Leadership. Ms. Lynch is a member of our firm's Technology and Intellectual Property section and can be contacted at 410.347.8703 or dlynch@wtplaw.com.

Q: What steps can your nonprofit association take to help prevent cybersquatting and enforce trademark rights against cybersquatters?

A: Nonprofit associations are as vulnerable to cybersquatting—the bad faith registration, sale, or use of a domain name that is identical or confusingly similar to another's trademark—as are for-profit companies. According to the Coalition Against Domain Name Abuse (CADNA), cybersquatting costs trademark owners more than $1 billion each year due to lost sales, lost goodwill, and increased enforcement costs.

A typical example of cybersquatting is the adoption of another person or organization's trademark as a domain name with the intent to sell the domain name to the trademark owner at a profit or to drive traffic and business to other interests. Other examples include:

• ***Tasting***—the registration of millions of domain names (typically including trademarks of others) to test which will produce enough traffic for a positive return on investment. By exploiting the five-day grace period for finalizing domain-name purchases currently allowed by the Internet Corporation for Assigned Names and Numbers (ICANN), "tasters" can cancel at no cost the purchases of domains that don't pass the test.

• ***Kiting***—the registration of a domain name, followed by deleting it during the grace period and immediately reregistering it. The process is repeated so that the registration is maintained without ever being paid for. This means that an honest registrant wishing to register a "kited" domain name for a legitimate purpose would be unable to do so.

• ***Typosquatting***—the registration of a domain name that is a common misspelling of a legitimate and popular site. When web users type in the misspelled domain name, they arrive at sites that display advertising that generates pay-per-click commissions for the domain-name registrant.

To protect your valuable intellectual property, the following practices are recommended:

Police the marketplace. Retain or implement a watch

continued next page

service that will notify you of recently registered top level domain names (such as .biz, .com, .info, .net, .org, *etc.*) that are identical or confusingly similar to your trademark.

Register domain names defensively. Register your association's trademark in various forms (.biz, .com, .info, .net, .org, *etc.*) with common typographical errors and/or hyphenated versions to prevent others from doing so. The number of variations will depend upon your association's budget.

File a domain name dispute proceeding. If a domain name has been registered in bad faith, one option is to file a domain name dispute proceeding under ICANN's Uniform Domain Name Dispute Resolution, which applies to all registrants and registrars of global, top-level domain names and requires a dispute to be handled through a proceeding filed with an ICANN-approved dispute-resolution service provider. A domain name dispute proceeding is usually faster and less expensive than litigation, but a claimant may only obtain the cancellation or transfer of the domain name, not monetary damages or attorneys' fees.

File a lawsuit under the federal Anti-Cybersquatting Consumer Protection Act (ACPA). Another option is to file an action under ACPA, which permits a plaintiff in federal court to obtain injunctive relief, actual damages, or statutory damages of up to $100,000 per domain name, and, in some cases, attorneys' fees. However, a lawsuit is generally longer and more expensive than a domain name dispute proceeding.

Beware of other domain name abuses. Associations should be wary of unsolicited correspondence that purports to advise you of abuses of your trademarks or domain names, particularly in China. For example, "urgent" emails reporting that another company is attempting to register your association's trademark as a ".cn" domain name in China and requesting a prompt response in order to block the registration, may be part of a fraudulent marketing scheme. Your association should carefully investigate these unsolicited claims, even ones from accredited domain name registrars in China, before taking any action and especially before paying any fees or providing a credit card number. There may, of course, be valid reasons for registering a .cn domain name, but you might wish to consider a different registrar.

In sum, while measures are being taken by trademark owners, governmental bodies, and within the industry, cybersquatting remains a threat to the value and goodwill of an association's trademarks. Taking proactive steps to prevent cybersquatting and taking legal action when necessary are vital to an association's domain name protection and enforcement strategy.

Dana O. Lynch

Q&A

Q: I heard that nonprofit corporations don't have stockholders. Is that correct?

A: Most Maryland corporations that will operate on a nonprofit basis are formed as "nonstock" corporations under a separate portion of the jurisdiction's corporation law. In that regard, it is true that most Maryland nonprofit corporations do not have stockholders. However, such corporations can have "members." Members are similar to stockholders in that they usually have the authority to elect the nonstock corporation's board of directors and approve extraordinary corporate actions. But, unlike stockholders, members of such corporations typically have no ownership or equity rights. It also is worth noting that nonstock corporations are not required to have members; in that case, the members of the corporation's board of directors will constitute the members of the corporation and will exercise the rights and powers of members. This is typically referred to as a "self-perpetuating board" structure because the directors elect their successors.

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Understanding the business of nonprofits

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