

# 2021 HCCA COMPLIANCE INSTITUTE REASONABLE COMPENSATION IN HEALTHCARE ORGANIZATIONS

James G. Sheehan  
Chief, Charities Bureau  
Office on NY Attorney General Tish James  
April 20, 2021

1

## Topics For Today's Presentation

- IRS Nonprofit executive compensation regulatory process
- What compliance officers need to know about executive compensation process
- Executive compensation process requirements are a compliance risk-who should own the process?
- Core compliance issues: training, monitoring, auditing, reporting, resolution-do you dare get into this?

2

2

## How Much Do Hospital CEOs Make?(2019)

- CEO MemorialCare Health System Fountain Valley, Ca.
- \$11,671,114 total; (\$1,369,502 base)
- CEO NY Presbyterian, New York City
- \$10,375,520 total; (\$2,016,101 base)
- CEO, Christus Hospital Irving Texas
- \$8,344,473 total; (\$4,351,450 base)
- CEO, UPMC, Pittsburgh
- \$8.96 million total; (\$1.2 million base)

3

## GROWING SCRUTINY OF CEOS AND MAJOR HOSPITAL SYSTEMS

- Hospital executive salaries
- Real estate tax exemptions challenges (NJ, Ill., Pa.)
- Financial assistance programs-eligibility
- Collection activities (NPR- Tenn., NC, Mo., Va.)

4

## Why Special Attention to Compensation of Hospital Executives in Nonprofit Hospitals?

- Publicly disclosed by name and title on IRS 990s each year
- Hyper-local attention and interest
- Largest employer in many localities
- Often best-paid local executive
- AG and IRS responsibility for scrutiny of reasonableness of charity salaries
  - State Statute allows only “reasonable” compensation out of charity resources
  - IRS tax code prohibits “excess benefit” to disqualified persons (executives)

5

## Charitable Entities

- Prohibition on private inurement-distribution of charitable assets to private person
- Requirement of IRS 990 Part IV, Question 25a and 25b
- “Did the organization engage in an excess benefit transaction with a disqualified person during the year?”
- 25b-prior years?
- “Disqualified person” –able to “substantially influence its affairs by exercising or sharing responsibility for supervision, management, or administration of its operations.” Treasury Regulation 53.4958-3 e(2)

6

## REASONABLE COMPENSATION IN THE IRS 990 WORLD

- Question 15 of IRS 990 Part VI:
- Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?
  - A) The Organization's CEO, Executive Director, or top management official?
  - B) Other officers or key employees of the organization
- If yes, describe the process in Schedule O (see instructions)

7

## The IRS "Rebuttable Presumption" Model for Reasonable Compensation

- 26 CFR § 53.4958-6 - Rebuttable presumption that a transaction is not an excess benefit transaction
- Payments under a compensation arrangement are presumed to be reasonable, and a transfer of property, or the right to use property, is presumed to be at fair market value, if the following conditions are satisfied (slide 9) .
- the Internal Revenue Service may rebut the presumption that arises under paragraph (a) of this section only if it develops sufficient contrary evidence to rebut the probative value of the **comparability data** relied upon by the authorized body.
- Avoiding liability for executives for intermediate sanctions for paying "excess benefits" to "disqualified persons"
- [https://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](https://www.irs.gov/pub/irs-tege/governance_practices.pdf)

8

## REASONABLE COMPENSATION IN THE IRS 990 WORLD-990 Instructions (2020) (at IRS.gov)

- Answer “yes” “if, during the tax year, the organization (**not a related organization or other third party**) used a process for determining compensation . . . Of the CEO, executive director, or other person who is the top management official, that **included all of the following elements: (shown on next slide)**

9

“Process for determining comp. . . included all of the following elements”

- **Review and approval by a governing body or compensation committee**
- **Contemporaneous documentation and recordkeeping for deliberations and decisions regarding the compensation arrangement**
- **No person with a conflict of interest regarding the compensation arrangement may be involved in the review.**

10

“ . . . included all of the following elements . . . ”

- No person with a **conflict of interest** regarding the compensation arrangement may be involved in the review.
  - “Conflicts of Interest”
  - The CEO may not be in the meeting where the decision is discussed or made
  - The committee member or a family member is participating in or economically benefitting from the arrangement
  - The member is in an employment arrangement subject to the direction or control of any person participating in or economically benefitting from the comp arrangement
  - The member receives compensation . . . Subject to the approval by any person participating in or economically benefitting from the compensation arrangement
  - The member has a material financial interest affected by the compensation arrangement
  - The member approves a transaction providing economic benefits to any person participating in the compensation arrangement, who in turn has approved or will approve a transaction providing economic benefits to the member.

11

“Review and approval by a governing body or compensation committee”

- IRS must be Board or Board level committee (Finance, Compensation)
- Some state laws have same requirement.

12

## Contemporaneous Documentation and Recordkeeping for Deliberations and Decisions Regarding the Compensation Arrangement

- Documentation
  - Comp surveys and data sources (e.g. GuideStar Nonprofit Compensation Report <https://learn.guidestar.org/hubfs/2019-CompReport-Sample.pdf>)
  - Outside compensation consultants and their databases for comparables
  - Reviews of similar organization's 990s
  - Written comp consultant report
  - Recorded vote of committee or board
  - Minutes reflecting decision
  - How did the committee or Board pick the percentile
  - "Compensation" includes salary, bonus, other comp elements
  - Corporate Secretary should have policy maintaining documentation, custody of records

13

## How About Other Executives?

- Part VI, Question 15(b) –same process for other "officers or key employees" of the organization.
- "If Yes to line 15a or 15b, describe the process in Schedule O.

14

## THE COMPENSATION PROCESS: A SAMPLE SCHEDULE O Explanation

The by-laws of Northwell Health, Inc. ("Northwell") create a committee of the board with full powers of the board to review and approve the compensation of officers and other key employees. The committee consists of approximately 6 trustees who have no connection to Northwell except as trustees and they have no conflicts as to matters they consider. The committee meets several times a year as needed but always meets in November/December to review and determine officer and key employee compensation for the following year. For purposes of their review the committee considers the recommendations of the CEO for all persons other than the CEO. For purposes of the review each year the committee receives information from an outside independent compensation consultant as to compensation for comparable positions in comparable organizations and makes its decisions on this basis, with the overall objective of paying base salary at the 50th percentile. Any contracts or other compensation for officers or key employees are separately considered and normally only approved after receipt of a "fairness opinion" from the independent consultant. All the work and process of the committee is structured to fall within the applicable safe harbor regulations.

15

## THE COMPENSATION PROCESS: A SAMPLE SCHEDULE O Explanation

The by-laws of Northwell Health, Inc. ("Northwell") create a committee of the board with full powers of the board to review and approve the compensation of officers and other key employees. The committee consists of approximately 6 trustees who have no connection to Northwell except as trustees and they have no conflicts as to matters they consider. The committee meets several times a year as needed but always meets in November/December to review and determine officer and key employee compensation for the following year. For purposes of their review the committee considers the recommendations of the CEO for all persons other than the CEO. For purposes of the review each year the committee receives information from an outside independent compensation consultant as to compensation for comparable positions in comparable organizations and makes its decisions on the basis, with the overall objective of paying base salary at the 50th percentile. Any contracts or other compensation for officers or key employees are separately considered and normally only approved after receipt of a "fairness opinion" from the independent consultant. All the work and process of the committee is structured to fall within the applicable safe harbor regulations.

16

## Even If Not Key Employees-Physicians as Five Highest Compensated Employees Visible on 990

- Report on 990 at Section VII:
  - five current highest compensated employees with reportable compensation of at least \$100,000 from the organization and related organizations who are not officers, directors, trustees, or key employees of the organization.
- No governance reporting requirement that institution follow “rebuttable presumption” model with non-manager high comp physicians:
- BUT-challenges of explaining independent process with executives but not with high physicians may be challenging in Stark FCA litigation

17

## SAMPLE IRS 990-Wheeling Hospital (FYE 9/18)

- Part VII- 5 highest compensated employees
- D.B. (cardiology) \$1.541 million
- G.M.(urologic oncology) \$1.301 million
- J.P. (radiation oncology) \$1.179 million
- C.S. (ob/gyn) \$1.069 million
- V.M. (cardiothoracic surgeon) \$868,000
  - Key employee CFO \$333,364
  - Key employee CMO \$531,061

18

## SCHEDULE J Questions Regarding Compensation-Required Reporting

- Question 1a (other benefits)
  - First class or charter travel
  - Travel for companions
  - Tax indemnification and gross-up payments
  - Health or social club dues
  - Follow written policy regarding payment or reimbursement? yes
  - Question 3-techniques to establish comp for executive director
  - Part II-base comp/bonus and incentive comp
  - Question 1b-if any “other benefits” provided, “did the organization follow a written policy regarding payment or reimbursement. . .”

19

19

## SCHEDULE J Questions Regarding Compensation-Required Reporting

- Part III-supplemental information
- #3-”indicate which if any of the following the filing organization used to establish the compensation of the CEO?
- #4-other benefits
  - change of control payment
  - supplemental retirement plan

20

## CHARITABLE ENTITIES- Excess Benefit Transactions and Liabilities

- Excise tax to person and managers
- Completion of IRS form 4720 Excise tax reporting form
  - 21 percent excise tax on ATEOs that pay excess annual compensation (different from excess benefits)
- Payment of unauthorized expenses (not pursuant to an accountable plan)
- W-2 reporting
- 1099 reporting
- 941 reporting and withholding (quarterly wages)
- Executive use of any of the charity's assets, such as a cars, real estate, credit cards, sports tickets, for other than fulfilling the charity's exempt purposes, were properly included in compensation and properly included in the insider's Form W-2 or Form 1099

21

## EXCESS BENEFIT TRANSACTIONS WITH EXECUTIVES - NOT JUST COMPENSATION

- the sale of a charity's asset to an executive;
- the charity's purchase of an asset from an executive;
- the charity's rental of property from, or to, an executive;
- the charity's lending of money to an executive;
- Payment of travel and entertainment expenses without required records, receipts, or approvals;
- the use of facilities and/or other assets of the charity by an executive.

22

## Should a Compliance Officer Have Any Role in CEO/ Senior Executive Compensation Compliance?

- Who owns the process? (Should be the Board)
- Who has the responsibility to educate the Board on the requirements for compliance with executive compensation (outside consultant, General Counsel)
- Who has the responsibility to review the compensation business process for compliance?(could be Corporate Secretary/General Counsel)
- Who has responsibility to monitor whether the compensation committee or the Board complied with the business process each year?
- Who has the responsibility to assure that the compensation business process and the text answers are accurately reported on the IRS 990 each year?

23

## Should a Compliance Officer Have Any Role in CEO/ Senior Executive Compensation Compliance? (2)

- Who has the responsibility for identifying violations of the law or the business process?
- Who has the responsibility for identifying potential tax liabilities?
- Who has the responsibility for reporting violations on the IRS 990 or filing form 4720.
- Who is responsible for correcting prior false reporting to the IRS or states for prior years?
- Who handles whistleblower complaints concerning compensation for the CEO or other senior executives?

24

# Thank you!

- Jim Sheehan
- [James.Sheehan@ag.ny.gov](mailto:James.Sheehan@ag.ny.gov)
- 212 416 8490