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TREND WATCH: State proposals to limit CEO salaries at state-funded nonprofits

While the level of executive salaries at nonprofit organizations has long been a regulatory concern of the IRS, several states are now delving into the compensation fray. This past May, New York Governor Andrew M. Cuomo issued proposed regulations to implement Executive Order 38 (signed by Governor Cuomo in January 2012) that will cap CEO salaries at nonprofit organizations that receive state funds. A nonprofit organization that receives more than $500,000 per year in state funds and whose funding from the state is at least 30 percent of its total annual funding will now be prohibited from using more than $199,000 in state funds towards an executive's compensation. Nonprofits that wish to pay an executive more than $199,000 by pulling from other funds must ensure that the compensation is below the top 25 percent of salaries in the same field. The state may grant a salary waiver, but only after the nonprofit completes a rigorous reporting and independent review process.

According to Governor Cuomo, the proposed regulations will "ensure that New York taxpayers are protected and the public's money is spent efficiently and effectively." Though some charity watch dog organizations warn that the regulations will cause top nonprofit talent to flee the state, others believe that the rules are a much-needed public policy measure that will encourage fiscal responsibility, curb exorbitant nonprofit salaries paid for by taxpayers, and inspire public trust in state-funded service providers. This also comes at a time when some nonprofit CEO salaries easily surpass the $1 million mark, while many taxpayers continue to struggle in this weak economy and state governments search for ways to cut costs.

Several other states have either passed or are considering similar limitations, which may indicate an emerging trend in state governments' regulation of nonprofit compensation practices. For example, for the past two years, New Jersey has prohibited charities from paying execs more than $141,000 with state funds. Earlier this year, a Florida State Senate committee approved a bill (SB 596) to limit executive salaries at $129,972 for nonprofits that obtain the majority of their revenue from state government sources. (The bill ultimately stalled in the State's Governmental Oversight and Accountability Committee, but another similar measure is expected to be proposed in 2013.) Like Governor Cuomo of New York, the Florida bill's sponsor, State Senator Ronda Storms, cited concerns for overburdened taxpayers in this weak economy as the reason for the proposed measure explaining, "[i]f you don't take a dime of taxpayers' money, you don't have to worry."

New York's nonprofit salary cap regulations are expected to go into effect in January 2013. Nonprofits that violate the regulations face fines, the redirection of state funds, and the revocation of their license to operate programs in the state. Though the penalties may seem steep, a spokesperson for the New Jersey Department of Human Services offered that since their state's salary caps went into effect, there have been no violations.

For more information about this emerging trend and other nonprofit compensation issues, contact ***Chip Grange*** *or* ***Steve King*** *of Gammon & Grange at (703) 761-5000.*