



Published on National Council of Nonprofits (<https://www.councilofnonprofits.org>)

Original URL: <https://www.councilofnonprofits.org/running-nonprofit/employment-hr/compensation-nonprofit-employees>

Compensation for Nonprofit Employees

If your nonprofit hires employees (perhaps in addition to engaging [volunteers](#)), both state and federal laws will control their compensation, working conditions, and to some extent their fringe benefits. Accordingly, implementing compensation practices legally is an area that requires careful attention, and may call for professional guidance.

Hiring any employee triggers a host of legal requirements, from filing with the state to report a "new hire," to determining the appropriate compensation, to calculating "withholdings" from compensation for tax purposes.

This page does not attempt to cover all these issues, but rather to validate how important it is to compensate employees fairly and debunk the myth that "nonprofits only have volunteers."

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We also want to encourage those managing nonprofits with employees to recognize that nonprofits compete with for-profit workplaces for talented workers, so setting the right level of compensation can make the difference between attracting and retaining qualified employees or, in contrast, suffering from high turnover and/or not being able to retain talented employees. While it's another myth that "*good benefits make up for low compensation*," generous benefits are definitely an important factor in hiring and retaining employees.

How much should a nonprofit pay its employees?

Tax-exempt charitable nonprofits, like all other employers, are required to follow federal and state wage and hour laws that require employers to pay minimum wage. At the upper end, compensation must be "reasonable" and not "excessive," which is a fundamental requirement of [maintaining tax-exempt status](#). It is helpful to know what the going rate is when you are hiring a new staff member by reviewing "comparability data," which are data about salary and benefits from other nonprofits in the same or a similar geographic area, with a similar budget and mission focus. Many [state associations of nonprofits](#) collect salary and benefit information via regular surveys, and produce state-specific reports that allow nonprofit employers to compare compensation of similar organizations by job titles/responsibilities. These data may be free or discounted to members as a benefit of membership in a state association of nonprofits. Those [state-specific compensation reports can be found here](#).

Minimum wage and overtime

Employees must be paid the legally mandated minimum wage, that can differ state-to-state; there is also a federal minimum wage rate. Employers should pay whichever is higher. If employees (not independent contractors - it's important to [know the difference!](#)) work more than 40 hours in a work week, be aware that the nonprofit may owe those employees overtime compensation. ([Read more on breaking down your nonprofit's obligation to pay overtime here](#)). The number of

hours worked can also impact [retirement and health insurance plan benefits](#).

Approving executive compensation

It's a recommended "best practice" for the entire board of directors to be aware of, and *annually approve*, the executive director/CEO's compensation. This topic is so important we've devoted [an entire page of our website](#) to it! The definition of gross income for income tax purposes includes benefits, such as health insurance. Therefore, when analyzing an employee's "total compensation," fringe benefits such as paid leave, professional development, and continuing education need to be taken into account.

Can we pay nonprofit employees a bonus?

Yes: Bonuses are considered to be part of the overall compensation received by an employee. But note: First, compensation based on incentives, including bonuses, is carefully scrutinized by the IRS to ensure that no prohibited private benefit results. Second, be sure to manage employees' expectations so that they realize bonuses are a discretionary add-on to regular salary, dependent upon budget limitations, and often provided in recognition of an employee's extra-efforts or exceptional performance - not automatic. See [IRS guidance on incentive compensation](#).

Practice Pointers

- Compensation is more than just straight salary. The IRS considers "compensation" to include the total of all "income" received by the CEO, which includes, for example: contributions to retirement accounts, housing and car allowances, as well as insurance premiums paid by the nonprofit to benefit the executive director, and even club memberships if the membership primarily benefits the individual rather than the nonprofit. (See IRS Form 990 [instructions](#) , pages 29-31.)
- Learn why paying a commission or percentage of funds raised to staff or independent contractors with responsibility for fundraising is considered unethical by many: [Position Paper: Percentage Based Compensation](#) (Association of Fundraising Professionals)

- Nonprofits report bonuses (including signing bonuses), and any compensation based on incentives, on Form 990, Schedule J, Part II, Column B 2 (ii). Remember: care must be taken to justify all compensation as reasonable and not excessive.
- Nonprofits that file the IRS [Form 990](#) or [990-EZ](#) are required to report compensation, so for those nonprofits, it is easy for others to see what the nonprofit paid its highest paid staff members.
- Make sure your hiring practices and job postings are both legal and equitable: see [Can New Laws and Practices Address Pay Disparities?](#) (February 2022)
- Review salary and benefit reports that contain comparable data. [State specific reports](#) are often available from your state association of nonprofits, with discounts available for members. Several national survey reports on nonprofit compensation are available for purchase (Candid, The Nonprofit Times, and Columbia Books publish reports), and free reports are available in a few regions from staffing firms and other sources.

Additional Resources

- [6 Practices for Embedding Equity in Nonprofit Compensation](#) with Mala Nagarajan (Fund the People podcast, April 2023)
- [Payroll taxes: the one payment a nonprofit should NEVER skip](#) (For Purpose Law Group)
- [Performance and Compensation Practices](#) (Minnesota Council of Nonprofits)
- [Salary Information for Nonprofits](#) (Candid)
- Some [state charity officials](#) address compensation issues in the guidance published for nonprofits in their states and undertake periodic investigations or reviews of nonprofit compensation in their states.

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