

1. Title

Determining and Documenting the Reasonableness of Compensation

2. Rule and Regulation

Sec. 1 Setting of Compensation. Institutions of The University of Texas System are charged with setting compensation levels for Highly Compensated Personnel in such a way that compensation is reasonable and adequate documentation is maintained for supporting the reasonableness of compensation paid. Internal Revenue Code (IRC) [Section 162](#) imposes a reasonableness requirement for the deductibility of compensation as a business expense and its applicability has been extended to tax-exempt organizations. IRC [Section 4958](#) imposes excise taxes on excess benefit transactions between a tax-exempt organization and certain influential persons within the organizations. Although the U. T. System is not subject to the IRC sections, the process used to determine compensation by U. T. System shall be pursuant to a process in conformance with the spirit of the Internal Revenue Service (IRS) guidelines including any applicable factors previously used by the IRS to determine reasonable compensation (see Definitions) as well as any other factors deemed relevant.

Sec. 2 Compliance with IRS Guidelines. The Chancellor shall develop a Systemwide policy for establishing the compensation for Highly Compensated Personnel, not covered in Regents' *Rules and Regulations*, [Rule 20203](#) (which outlines the procedures for establishing the compensation of the presidents and executive officers at System Administration), that is in conformance with the spirit of the factors referenced in Section 1 above.

Sec. 3 Approval required.

3.1 Board Approval. Initial Total Annual Compensation and changes to Total Annual Compensation that may exceed the amount set as the approved institutional contract threshold discussed in Regents' *Rules and Regulations*, [Rule 10501](#), Subsection 2.2.17 must be approved by the Board of Regents, except as otherwise required or allowed by [Rule 10501](#) for athletic directors or coaches or by Subsection 3.2 below. This approval can occur through the approval of the annual operating budget or as a stand-alone item during the fiscal year.

- 3.2 Chancellor approval. The Chancellor may approve changes of up to five percent per year in an institutional employee's Total Annual Compensation that was approved by the Board pursuant to subsection 3.1 if the changes were not included in the annual operating budget.
- 3.3 Documentation required. In all cases, the employing institution is responsible for maintaining documentation that the compensation was established or changed in accordance with applicable Systemwide policy.

3. Definitions

Factors Previously Used by the IRS -

- 1) the nature of the employee's duties;
- 2) the employee's background and experience;
- 3) the employee's knowledge of the business;
- 4) the size of the business;
- 5) the employee's contribution to the profit making;
- 6) the time devoted by the employee to the business;
- 7) the economic conditions in general and locally;
- 8) the character and amount of responsibility of the employee;
- 9) the time of year when compensation is determined;
- 10) the relationship of shareholder-officer's compensation to stock holdings;
- 11) whether alleged compensation is in reality, in whole or in part, payment for a business or assets acquired; and
- 12) the amount paid by similar size businesses in the same area to equally qualified employees for similar services.

Highly Compensated Personnel – personnel whose Total Annual Compensation is, or may exceed, \$1 million in any year and who are not covered in Regents' *Rules and Regulations*, [Rule 20203](#) (Compensation for Key Executives).

Total Annual Compensation – includes an employee's salary or wages, practice plan supplements, incentive plan payments, and unpaid deferred compensation and excludes employer-provided insurance, expense allowances, employer contributions to Teachers Retirement System of Texas and Optional Retirement Program, and other fringe benefits.

4. Relevant Federal and State Statutes

Internal Revenue Code [Section 162](#) – Trade or Business Expense

Internal Revenue Code of 1986 [Section 4958](#) – Taxes on Excess Benefit Transactions

5. Relevant System Policies, Procedures, and Forms

Regents' *Rules and Regulations*, [Rule 10501](#) – Delegation to Act on Behalf of the Board

Regents' *Rules and Regulations*, [Rule 20202](#) – Cash Compensation for Chief Administrative Officers

Regents' *Rules and Regulations*, [Rule 20203](#) – Compensation for Key Executives

The University of Texas Systemwide Policy [UTS 144, *Establishing Compensation for Highly Compensated Employees*](#)

[Board Contract Approval Threshold Table](#) (October 5, 2022)

6. Who Should Know

Chancellor
Executive Vice Chancellors
Presidents

7. System Administration Office(s) Responsible for Rule

Office of the Chancellor

8. Dates Approved or Amended

[Regents' Rules Revision History](#)

9. Contact Information

Questions or comments regarding this Rule should be directed to:

- bor@utsystem.edu