

Excise Tax on Nonprofits: Executive Compensation

28 Jan 2019

Many tax-exempt organizations will now be required to pay an excise tax on any compensation over \$1 million paid to each of their top five employees. That amount of compensation, including end-of-career parachute payments, may be subject to the corporate tax rate, which is currently 21 percent.

Internal Revenue Code section 4960, enacted as part of the Tax Cuts and Jobs Act effective for all tax years beginning on or after January 1, 2017, imposes this tax on applicable tax exempt organizations, excluding compensation payments for the provision of medical services for direct patient care, including veterinary care provided for pets and livestock. The organization is liable for the excise tax, not the employee.

There were many questions associated with the application of the statutory language set forth in §4960, and the Internal Revenue Service recently issued Notice 2019-09 providing interim guidance. The Department of Treasury is expected to issue proposed regulations incorporating and expanding this guidance.

Of particular note is that independent contractors of the tax-exempt organization do not trigger the §4960 tax. Therefore, consultants, board members, outside fundraisers, and similar independent service-providers may receive substantial remuneration without causing the organization to pay the 21 percent excise tax.

Another factor of note is that §4960 operates independently of the other excise taxes applicable to tax-exempt organizations. If an organization's employee(s)' compensation triggers the §4960 tax, then it is not determinative as to whether that compensation is an excess benefit subject to tax under §4958. Or, if the organization is a private foundation, the §4960 tax has no impact on whether the self-dealing excise tax under §4941 is applicable. Those determinations are made based independently on "all facts and circumstances".

When an employee is paid separately by several related organizations, the amounts are combined and if total compensation is over \$1 million, the related organizations are liable for the excise tax proportional to their percentage share of the payments.

As with most compensation, if it is subject to a substantial risk of forfeiture and not included in an employee's taxable income, then it is also not included in the calculation of the §4960 excise tax until the year in which the compensation vests.

The excise tax is also applicable to parachute payments upon termination of employment. The tax is triggered if a highly compensated soon-to-be former employee is to receive a payment contingent on separation from employment, and that payment is more than three times the amount of base pay. If any excess amounts are not payable until a future tax year, the employer may elect to pay the excise tax in the year of separation.

This is a simplified summary of the new provisions. Many of these calculations are dependent upon the specific facts of each tax-exempt organization and of each employee who may trigger the excise tax. Therefore, Jackson & Campbell, P.C. encourages you to consult with your tax advisors on these issues if your organization may be subject to §4960.

This alert is not intended to contain legal advice or to be an exhaustive review of the opinion. If you have any questions about the intricate details of this case, or the interpretation of tax treaties generally, please contact [Nancy Ortmeyer Kuhn](#), Esq. at Jackson & Campbell, P.C.

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TAGGED: Tax Cuts and Jobs Act, Internal Revenue Code, Internal Revenue Code section 4960, Notice 2019-09, §4960