

PRESENTED AT

6th Annual Higher Education Taxation Institute

June 3-5, 2018
Austin, TX

**New Excise Tax Applicable to Tax-Exempt
Organizations**

Tara S. Sciscoe

Author Contact Information:

Tara S. Sciscoe
Ice Miller LLP
Indianapolis, Indiana

Tara.Sciscoe@icemiller.com
317.236.5888

NEW EXCISE TAX APPLICABLE TO TAX-EXEMPT ORGANIZATIONS

In addition to changing the tax rates and rules applicable to individuals and corporations, the Tax Cuts and Jobs Act ("Act"), signed into law on December 22, 2017, added new rules affecting the executive compensation paid by certain tax-exempt organizations. Specifically, new Internal Revenue Code ("Code") Section 4960 imposes an excise tax on **"applicable tax-exempt organizations"** that pay excess compensation to their most highly compensated employees. The new excise tax is effective for tax years beginning after December 31, 2017, and, therefore, is already in effect.

WHAT IS THE NEW EXCISE TAX?

New Code Section 4960 imposes a 21% excise tax on excess compensation paid to a **"covered employee"** for a taxable year. Excess compensation includes both:

1. **"remuneration"** (not including excess parachute payments) in excess of one million dollars for the taxable year; and
2. **"excess parachute payments"** for the taxable year.

Comment: The excise tax applies to a covered employee who receives excess parachute payments *even if* the employee is not paid over one million dollars for the taxable year. Accordingly, applicable tax-exempt organizations whose most highly compensated employees earn substantially less than one million dollars will need to consider this new excise tax as well.

Comment: The term "taxable year" is not defined in the Act, and it is not clear whether this means the applicable tax-exempt organization's fiscal year or the calendar year.

Comment: 21% is the new corporate income tax rate under the Act. Under Code Section 162(m), certain corporations are denied a deduction for excess compensation. This new excise tax results in similar adverse tax consequences for applicable tax-exempt organizations that pay excess compensation.

WHAT TAX-EXEMPT ORGANIZATIONS ARE SUBJECT TO THE NEW EXCISE TAX?

Code Section 4960 applies to **"applicable tax-exempt organizations"**, which are defined to include all of the following:

1. Organizations exempt from tax under Code Section 501(a), including:
 - Any organization described in Code Section 501(c), such as a charitable organization, social welfare organization, trade association, labor organization, social club, fraternal society, voluntary employee benefit association (VEBA), or veterans' organization.

Comment: This category appears to include a governmental university or hospital that is dual-qualified, *i.e.*, has secured a determination letter under Code Section 501(c)(3) in addition to being tax-exempt due to its governmental status.

- A religious or apostolic organization organized for the purpose of operating a communal religious community under Code Section 501(d).
- A qualified trust forming part of a pension or profit sharing plan of an employer under Code Section 401(a).

Comment: A custodial account or annuity contract is treated as a qualified trust under Code Section 401(a) if it satisfies certain requirements.

- A trust under a governmental 457(b) plan, a 403(b)(9) retirement income account, or a 403(b) custodial account.

Comment: Governmental retirement systems and denominational church plans are, therefore, subject to the new excise tax.

2. Farmers' cooperative organizations exempt from tax under Code Section 521(b)(1).
3. Organizations whose income is excluded from taxation under Code Section 115(1). Code Section 115 exempts from tax the income of entities that are separate and distinct from states and political subdivisions but that serve an essential governmental function and whose income accrues to a state or political subdivision. Entities that rely on the Code Section 115(1) exemption may include universities, hospitals, libraries, port authorities, fire associations, soil and water conservation districts, health plans, pooled liability funds, and economic development corporations.

Comment: The IRS has concluded that states and political subdivisions—and the integral parts of states and political subdivisions—are exempt from federal income tax under the doctrine of intergovernmental immunity. Political subdivisions of a state include counties, cities, towns, and school districts. Significantly, public colleges and universities frequently qualify as either political subdivisions or as integral parts of states or political subdivisions. To the extent an organization of this type does not rely on Code Section 115(1) for exemption from tax, it appears not to be an applicable tax-exempt organization unless it has obtained a determination letter under Code Section 501(c)(3), as discussed above.

4. Political organizations, such as political action committees ("PACs"), described in Code Section 527(e)(1).

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

Title search: New Excise Tax Applicable to Tax-Exempt Organizations

Also available as part of the eCourse

[2018 Higher Education Taxation eConference](#)

First appeared as part of the conference materials for the
6th Annual Higher Education Taxation Institute session

"People Payments: Executive Compensation Tax Issues"