

Issue At A Glance: Penalty Excise Tax Increase For Tax Exempt Organizations

Under the Pension Protection Act of 2006, the penalty for "excess benefit transactions" has been increased from \$10,000 per occurrence to \$20,000. The penalty was enacted in 1996 during the Clinton Administration to impose sanctions for entering into excess benefit transactions resulting in financial benefits by "disqualified persons", who knowingly and willingly allow these transactions to occur.

The penalty will affect all 501(c)(3) and 501(c)(4) organizations. An excess benefit transaction occurs when a monetary benefit is provided directly or indirectly by an organization to a disqualified person when the amount exceeds the value of the services received.

DISQUALIFIED PERSONS

Any person who is in a position to exercise "substantial influence" over the affairs of an organization, including:

- ⌘ family members,
- ⌘ an entity with 35% ownership,
- ⌘ a foundation,
- ⌘ a donor advised fund, or
- ⌘ a sponsoring organization.

INDIVIDUALS WITH SUBSTANTIAL INFLUENCE

- ⌘ Board of Directors and Trustees.
- ⌘ The President, Chief Executive Officer, or Chief Operating Officer.
- ⌘ The Treasurer or Chief Financial Officer.
- ⌘ Anyone who shares responsibility for managing the organization's finances.

PENALTIES IMPOSED ON EXCESS BENEFIT TRANSACTIONS

- ⌘ 25% excise tax applies to the amount of the excess benefit plus a 10% penalty limited to \$20,000.
- ⌘ The individual who had knowledge of the transaction will be charged per occurrence or transaction.
- ⌘ Organizations that are or become aware that they have entered into an excess benefit transaction are required to report the excess benefit transaction to the IRS and take action to recover the excess benefit amount.
- ⌘ Failure to take corrective actions to recover the excess benefit will increase the penalty excise tax rate to 200% of the excess benefit amount.