



Anatomy of an Excess Benefit Transaction

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[Learning Objectives]

At the end of this session, you will be able to:

- Recognize types of transactions that your organizations should avoid
- Protect your organization from automatic benefit transactions

[Statement of Legal Issue]

- Intermediate Sanctions regulations set forth a process for certain exempt organizations to follow to shift burden of proving reasonableness to IRS
- To satisfy the process, the value of all benefits must be included
- Failure to include all benefits can result in an automatic excess benefit

[Intermediate Sanctions]

- Background
- Organizations Covered: 501(c)(3) and (c)(4)
- Not Private Foundations

[Intermediate Sanctions]

- Penalties Established
 - 1st Tier Tax: 25% excess benefit on disqualified person
 - 2nd Tier Tax: 200% excess benefit if not corrected
 - Manager Tax: 10% excess benefit on any manager (not to exceed \$20,000 currently)

[Intermediate Sanctions]

- Disqualified persons are those in a position to exercise substantial influence over affairs of organization.

- Including:
 - Board members
 - CEO, COO, Treasurer, CFO
 - Immediate family of, and entities controlled by above listed persons

Intermediate Sanctions

- Excess benefit is one that exceeds fair market value of consideration for payments.
 - Property: Willing Buyer/Seller
 - Compensation for Services: Amount (including value of benefits) ordinarily paid for like services by like enterprises under like circumstances

[Intermediate Sanctions]

- Rebuttable presumption procedure.
- Since 1995, a Protective Provision exists, that, if followed, creates a rebuttable presumption of reasonableness.
- Flips burden onto government to prove compensation unreasonable.
- Several proposals brought forward to eliminate the rebuttable presumption.

Intermediate Sanctions

- Rebuttable Presumption Requirements
 1. Compensation approved in advance by authorized body of organization composed **entirely** of individuals without a conflict.
 2. Relied upon appropriate data.
 3. Adequately documented basis for decision.

Intermediate Sanctions

- Reporting Compensation: All economic benefits must be reported as compensation on a form W-2, 1099, and the organization's IRS form 990, before the beginning of an IRS examination into the compensation.

Automatic Excess Benefit

- If the contemporaneous substantiation requirements are not satisfied, the IRS will treat the economic benefit as an “automatic” excess benefit transaction without regard to whether:
 1. the economic benefit was reasonable,
 2. any other compensation the disqualified person may have received is reasonable, or
 3. the aggregate of the economic benefit and any other compensation the disqualified person may have received is reasonable.

Automatic Excess Benefit

- The IRS will make exceptions if it finds that there was a reasonable cause for the organization to have failed to substantiate the benefit.
- Reasonable cause generally means that the failure to report was a result of events outside of the organization's control, and that the organization took responsible steps both before and after the failure to report to prevent such a failure.

Automatic Excess Benefit

- Reimbursements of expenses incurred by a disqualified person, paid by an exempt organization to the disqualified person, are disregarded for purposes of 4958 if the expense reimbursements are made in compliance with an arrangement that qualifies as an “accountable plan.”

[Automatic Excess Benefit]

- However, if the organization does not satisfy the written contemporaneous substantiation requirements, the IRS will treat reimbursements paid under a “nonaccountable plan” as “automatic” excess benefit transactions.

[Example One]

- In 2010, XYZ paid \$15,000 to a local bank to pay off the President's mortgage to make up for all the years in which XYZ had been unable to raise the President's wages.
- XYZ intended for this benefit to be additional compensation to the President for services the President performed for XYZ from 2000 through 2010.
- XYZ did not withhold federal income taxes or employment taxes, and did not report the \$15,000 payment as wages on its form 941.

[Result Example One]

- All of the \$15,000 payment was an “automatic” excess benefit transaction in 2010, despite the following:
 - The total compensation paid the President in 2010, if treated as the full \$65,000, was reasonable in relation to the value of the services the President provided in 2010.

[Example Two]

- XYZ paid its President a salary of \$50,000 per year. EO had adopted an expense reimbursement program that qualifies as an “accountable plan.”
- In 2009, President traveled on a business matter but incurred personal expenses of \$2,500. The President failed to submit proper substantiation for the personal expenses, but was reimbursed by the organization, in full, for these personal expenses.
- XYZ did not report the \$2,500 payment as wages.

[Result Example Two]

- All of the \$2,500 payment was an “automatic” excess benefit transaction in 2009.

[Remediation]

- The IRS will apply a “facts and circumstances” test in determining whether to revoke tax exempt status when an organization has engaged in excess benefit transactions. The facts and circumstances include:

[Remediation Cont...]

- The size and scope of the organization's regular exempt activities;
- The relationship between the size and scope of the excess benefit transaction(s) and the organization's regular exempt activities;
- Whether the organization has a history of engaging in excess benefit transactions;
- Whether the organization has adopted compliance measures intended to prevent the occurrence of future intermediate sanctions violations; and
- Whether the excess benefit transaction has been corrected (or the organization has made a good faith effort to seek correction).



Thank You.

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