STRATEGIC INSIGHTS FOR POLICY MAKERS

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New Excise Tax: 4 Issues Boards Should Consider

457(f) payouts could trigger tax, but good options are available.

The tax reform law that took effect this year contains a classic good-news/bad-news scenario for some credit union executives. The good news: They're likely to pay a lower individual federal income tax rate. The bad news: Their employer could be hit with an excise tax on some executive compensation.

The Tax Cuts and Jobs Act includes a 21% excise tax on annual executive compensation that exceeds $1 million to any of a credit union's top-five paid executives. But don't dismiss this tax if your credit union doesn't pay any executive a salary greater than $1 million. The tax could still affect your credit union if you have deferred compensation arrangements in place for executives, such as a 457(f) plan.

CREDIT UNIONS COULD BE HIT WITH AN EXCISE TAX ON SOME EXECUTIVE COMPENSATION.

JOHN PESH

The 457(f) trigger

The new tax law may affect 457(f) plans because 457(f) payouts—unlike an annual bonus—typically are vested and disbursed periodically (or example, every five to 10 years), and in lump sums.

An event such as the executive's death, displacement due to a merger, or another disruptive incident may also unexpectedly trigger a 457(f) payout.

If an executive receives a payout from a 457(f) plan, and that payout results in more than $1 million in W-2 compensation for the executive in any given tax year, the credit union will be charged a 21% excise tax on the compensation that exceeds $1 million.

Boards of directors should consider the following to help navigate the new tax circumstances:

- **Consider restructuring your 457(f) plan** now if your executives are due to receive a deferred compensation payout in 2018. It may be possible to redesign some existing 457(f) plans and structure new plans to minimize exposure to the excise tax. For example, you might be able to restructure plans to add more frequent vesting intervals with correspondingly reduced payout amounts. Another option may be to replace or augment 457(f) plans with collateral assignment split-dollar life insurance. Work with your legal counsel and product providers to determine whether restructuring is possible and which alternative arrangements are available.
- **Weigh the potential excise tax liability** when setting up 457(f) plans in the future. Credit unions must set aside money in vesting years if payouts are projected to push an executive's annu-

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al compensation above the threshold. You should also accure any anticipated future excise tax expense should also be accrued to spread the expense over multiple years, if possible.

- **Consider investment payouts.** Some 457(f) plans don't have definite payout amounts. So even a 457(f) portfolio that wasn't expected to generate enough to put an executive over the $1 million annual threshold could do so if the investments outperform projections.
- **Advocate on behalf of credit unions.** Credit union industry advocacy groups and other affected organizations are already asking legislators to delay or eliminate this new tax. However, you should expect it to remain in effect for 2018. Consider participating in this advocacy effort. Reach out to your congressional representatives and advise them about the potential effects to your membership.

Credit unions had little time to plan for this new tax. The credit union industry was uncertain whether it would be included in the final bill until it was signed into law on Dec. 20, 2017. Now that it's in effect, leadership teams need to assess its potential impact quickly and be ready to act if necessary.

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New Excise Tax: Official Summary

The new excise tax is contained in Internal Revenue Code 4960, which was added by Section 13602 of the Tax Cuts and Jobs Act of 2017. Here's a summary of that section of the law:

> *This section imposes an excise tax on excess tax-exempt organization executive compensation. The tax is equal to the product of the corporate tax rate (21% under this bill) and the sum of: (1) any remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment (separation pay), as specified in the bill.*

You can find a PDF of the complete Tax Cuts and Jobs Act of 2017 at *docs.house.gov*.

Send us your comments:
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