5 Ways to Prepare for New Excise Tax

09/17/2018

Some credit union boards went on high alert over the new 21 percent federal excise tax on executive compensation—other boards dismissed it completely. We've seen both of these reactions turn out to be premature.

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

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

Now that the tax has been law for most of a year, let's review some best practices based on the most practical responses we've seen credit union boards take so far:

1. Review all executive compensation—whether or not it appears that an executive's salary and bonus will top $1 million in 2018 and beyond. All of an executive's W-2 compensation—including amounts an executive may vest into under a 457(f) plan—may be subject to the excise tax.

Some 457(f) plans are designed as one-time retirement payouts upon vesting, similar to how a retiring bank executive would cash out stock options at retirement. But other 457(f) plans are designed to pay out at periodic vesting intervals. For example, to create incentives for a credit union CEO or COO to stay for 15 more years, a credit union may offer a 457(f) plan that vests at three, five-year intervals.

The upshot is, if you have an executive due for a 457(f) vesting event in any given year, be aware of whether that will push total W-2 compensation above $1 million and trigger the excise tax.

2. Create a contingency plan for potentially large payouts to executives triggered by unpredictable events. Some 457(f) plans don't have definite benefit amounts. Therefore, even a 457(f) portfolio that wasn't expected to generate enough to put an executive over the $1 million threshold in a given year could do so if the investments outperform projections.

Also check 457(f) agreements for events that would trigger an acceleration of vesting, such as the executive's death, displacement due to a merger or another disruptive incident.

3. Consider restructuring 457(f) plans under certain circumstances. You may be able to redesign an existing 457(f) plan to minimize exposure to the excise tax. One way to do that is to add more frequent vesting intervals. Instead of three payouts at five-year intervals, make five payouts at three-year intervals. This doesn't create as strong an incentive for executives to stay with your credit union longer, but it may protect your credit union from the excise tax.

Also consider replacing or augmenting 457(f) plans with collateral assignment **split-dollar life insurance**.

Before making the decision to restructure a deferred compensation plan, work closely with your legal counsel and the product providers. You may find that the risk of excise taxes isn't worth the expenses involved in setting up a new arrangement.

4. Going forward, prepare for potential excise tax liability when setting up non-qualified deferred compensation plans or supplemental executive retirement plans. Amortize the expense of potential excise taxes over multiple years if you can, rather than absorbing the entire expense in a vesting year.

5. Join our industry's efforts to minimize or eliminate the effect of this law. Contact your congressional representatives and explain the potential effects of this tax on your membership.

In addition to credit union industry advocacy groups, the broader not-for-profit community, including cooperatives, associations and non-profits are asking legislators to delay or eliminate this new tax. Add your voice to theirs, especially if you had compensation agreements in place for executives before the new act went into effect. After all, our industry had very little time to plan for this new tax.

If your credit union is like most, in the absence of any change in tax law, your best ally in the effort to counteract this new tax is your executives themselves. Most will do what it takes to protect their credit union's bottom line.

John Pesh *is director of executive benefits at CUESolutions Platinum provider CUNA Mutual Group. For more information about benefits pre-funding and executive deferred compensation plans, contact him at 800.356.2644, ext. 665.8223. For more information about becoming a CUESolutions provider, please email kari@cues.org.*