

Executive Compensation Excise Tax FAQs



Executive compensation can raise a range of tax and planning questions, especially when high compensation levels, deferred compensation arrangements, vesting schedules, and separation-related payments are involved. The following FAQs address several common questions about Section 4960, including who may be considered a covered employee, what counts as remuneration, how deferred compensation is treated, and when the excise tax may apply.

What is the tax on executive pay for nonprofits?

Section 4960 imposes a 21% excise tax on tax-exempt organizations when a covered employee's annual remuneration exceeds \$1 million. The tax applies only to the portion of compensation above this \$1 million threshold.

What is a covered employee?

Starting in 2026, a covered employee is any employee of a tax-exempt organization, and any employee who was a covered employee in any prior year.

What about parachute payments?

Under the OBBBA, "excess parachute payments" will continue to exclude payments made to individuals not considered to be "highly compensated employees", as defined by IRC Section 414(q).

What counts as remuneration?

Remuneration is broadly defined. It includes W-2 wages (like base salary, bonuses, and taxable fringe benefits) and amounts paid by affiliated entities (like for-profit subsidiaries). It also includes deferred compensation. Payments to licensed medical professionals, including veterinarians, continue to be excluded from the definition of remuneration under the OBBBA.

What is deferred compensation?

Deferred compensation is compensation earned today that will be paid out in a future year — often at retirement or upon separation from services. These arrangements are sometimes referred to as "golden handcuffs," because they're designed to encourage to lengthen executives' tenure with the organization.

For purposes of the \$1 million threshold, deferred compensation is considered current year remuneration when it vests, not when it's paid.

When does deferred compensation vest?

Vesting occurs when the employee's right to compensation is no longer subject to a substantial risk of forfeiture — meaning, the executive has a right to those payments whether they leave the organization before retirement or fail to meet performance conditions.

What are some common deferred compensation vesting schedules for nonprofits?

Here are two common vesting schedules for nonprofit executives:

- **Time-Based Vesting Cliff**

When an executive is promised a \$500,000 bonus, to be paid out at retirement, once they've been employed for at least five years.

- Years 1–5: Not vested
- End of Year 5: Fully vested

The entire \$500,000 counts as remuneration at the end of Year 5, even though the payment hasn't been made.

- **Performance-Based Vesting Cliff**

When an executive is promised a \$600,000 bonus, to be paid out in equal installments over a three-year period, once and if the organization meets a funding target.

- Years before the funding target was met: Not vested
- Year the funding target is met: Fully vested

The entire \$600,000 bonus counts as remuneration in the year the funding target is met, even though the full payment hasn't been made.

Who pays the excise tax?

The nonprofit entity pays the excise tax, not the employee.

Because executive compensation arrangements can become more complex when deferred compensation, vesting events, affiliated entities, or separation payments are involved, organizations may want to review these arrangements carefully. A clearer understanding of how these rules work can help identify potential tax exposure and support more informed compensation planning.



Need Guidance? Contact Your CRI Advisor

Contact your CRI advisor at www.criadv.com/contact to discuss how executive compensation structures may affect your organization's tax and compliance considerations. Reviewing these arrangements carefully can help identify potential exposure, clarify how the rules may apply, and support more informed compensation planning.

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