IRS Intermediate Sanctions

Information for Current and Former Trustees, Officers, and Other Key Employees

What are intermediate sanctions?

Intermediate sanctions are penalties that the IRS can impose on persons involved in an excess benefit transaction, a transaction where the nonprofit organization pays more or receives less than fair market value.

Until 1996, when the IRS found excess benefit transactions that benefited current or former trustees, officers and others in key employees of a nonprofit organization, the only sanction available under the law was to revoke the organizations nonprofit status. Intermediate sanctions were added to the law in 1996 so that those involved in the transactions would be penalized, not the nonprofit organization. However, the IRS can still revoke an organizations nonprofit status when facts and circumstance so warrant.

What are excess benefit transactions?

Excess benefit transactions are transactions where a nonprofit organization pays more or receives less than fair market value. These transactions include:

- Compensation of officers, trustees and other key employees
- Purchases of goods and services
- Purchases, sales and leases of property
- Purchases and sales of investments

What are the penalties?

The law now provides an excise tax for individuals (referred to in the law as disqualified persons) who received the excess benefit and the organizational managers who approved of the transaction.

For the disqualified persons the penalty is two-tiered; if the excess amount is not paid by a specified time the penalty increases. First tier: the disqualified person must repay the excess amount in full with interest plus a 25% penalty within a specified period. Second tier: if the disqualified person does not repay the excess amount by a specified time, the disqualified person must repay the excess amount with interest plus an additional 200% penalty on the unpaid amount.
For organization managers, collectively, the penalty is 10% of the excess benefit up to a maximum of $20,000.

If more than one organization manager or other disqualified person is liable for an excise tax, then all of these persons are jointly and severally liable for the tax.

Who are disqualified persons?

Under the law, a disqualified person is any current or former person who is in a position to exercise substantial influence over the affairs of the nonprofit organization.

At the University, this would include current and former trustees, officers, and certain other key employees as determined by the University. The law attributes the disqualified person status of one of these individuals to their family members and any entity in which they or their family member holds a more than a 35% interest.

Who are considered to be former?

Trustees, officers and certain other key employees as determined by the University who were in a position to exercise substantial influence over the affairs of the University at any time during the 5-year period after the end of the person’s term or employment with the University.

Who are family members of disqualified persons?

Under the law, a family member includes an individual’s spouse, ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren, and the spouses of brothers, sisters, children, grandchildren, and great-grandchildren.

Who are organizational managers?

Under the law, an organizational manager includes any trustee, officer, director, or others who regularly make administrative or policy decisions on behalf of the organization. An organizational manager is involved in an excess benefit transaction if he or she knowingly participated. Participation includes silence or inaction where the manager has a duty to speak or act.

What is the University doing to protect against excess benefit transactions?

The University’s Board of Trustees has a Compensation Committee that annually reviews compensation for officers and deans. The Committee is advised by a compensation survey performed each year by an independent consulting company which gathers comparable data from a group of peer institutions. Minutes of the Compensation
Committee provide substantiation of the decisions. These procedures shift the burden of proof to the IRS if the reasonableness of compensation was in question.

For business transactions, the University obtains information about organizations in which trustees, officers, and other key employees as determined by the University and their family members have more than 35% interest and reviews those transactions. The Trustee Intermediate Sanction Committee reviews transactions involving these organizations and documents the decision. Documentation is maintained. These procedures shift the burden of proof to the IRS if the reasonableness of compensation was in question.

**What is your responsibility?**

Your responsibility is to understand intermediate sanctions as explained in this brochure. For disqualified persons, complete an annual conflict of interest statement. For organizational managers, be aware of transactions with disqualified persons and review such transactions and retain documentation that demonstrates that the transaction is at fair market value.

**Example of an excess benefit transaction and the penalties:**

A trustee’s husband owns 50% of a company that is providing construction services to the nonprofit organization. No review was performed on the contract to determine if it was at fair market value and the IRS determines that the organization paid $200,000 in excess of the value of the services. The trustee’s husband would be required to repay the $200,000 with interest and be assessed a $50,000 penalty (25% of $200,000). The organizational managers involved could collectively be assessed a total of $20,000, the maximum allowed under the law.

Assume the same facts and that only $100,000 with interest is repaid by the specified time. An additional penalty is assessed, $200,000 (200% of the unpaid amount, $100,000). Therefore, the total penalty is $250,000. The remaining $100,000 with interest is still to be repaid.