

TAX ON “EXCESSIVE” EMPLOYEE COMPENSATION



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TOPLINE: The One Big Beautiful Bill (OB BB) expanded the tax on “excess” compensation paid by nonprofit organizations to highly paid employees. For covered organizations, the tax was expanded to apply to *all* current and recent employees making more than \$1 million, instead of a more limited group of highly paid top executives and employees.

BACKGROUND: A 1993 [law](#) prohibited publicly-held corporations from deducting more than \$1 million of the remuneration of the Chief Executive Officer (CEO) or any of the company's four other highest-compensated officers. The 2017 Tax Cuts and Jobs Act (TCJA) [amended](#) that limitation so it explicitly applied to the Chief Financial Officer (and the *three* other highest-compensated officers) and made it so any employee once covered by the limitation in 2017 would always be covered by the limitation.

TCJA also created a parallel “excise” tax for nonprofit organizations on annual compensation above \$1 million (per employee) paid to their top-five compensated employees. To make it comparable to the limitation on deductions for highly compensated *corporate* employees, the tax rate on top-compensated nonprofit employees was set equal to the corporate tax rate of 21%.

What OB BB Did:

- [Broadened](#) the 21% tax on certain highly compensated nonprofit employees, so it isn't limited to the top-five compensated employees of an organization but instead applies to *any* employee of the organization receiving more than \$1 million in annual compensation.
 - The tax applies only to the portion of compensation exceeding \$1 million.

Why It Matters?

- A Tax Foundation [study](#) estimates the nonprofit sector comprises 15% of GDP.
- The *effective* marginal tax rate (not counting state and local tax) on certain highly compensated corporate employees whose marginal compensation is not deductible to the employer is about 53%. The tax on “excess” compensation of certain nonprofit employees makes their effective marginal tax rate 53% also.

Where Can I Find the Changes? OB BB Sec. [70416](#); [26 U.S.C. § 4960](#).

BOTTOMLINE: The government shouldn't be in the business of deciding what constitutes excessive compensation. However, to the extent that tax penalties on highly-paid corporate employees exist, parallel provisions for nonprofit organizations avoid pushing executives from corporations to nonprofits.

