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Client Alert: U.S. Tax Court Upholds Excise Tax Liability for Excess Benefit Transaction

On September 24, 2026, the U.S. Tax Court held in *Jagannath v. Commissioner*, Tax Court Memorandum Opinion 2026-92, that the president of a Section 501(c)(3) organization engaged in an excess benefit transaction under I.R.C. §4958. This transaction occurred when the president's wholly owned LLC received \$590,000 from the tax-exempt organization and the organization received no consideration in return. The president signed the interest-free promissory note as both the lender and the borrower, and the organization's 2016 and 2017 Forms 990 reported the amount as a loan to the president. The court rejected the president's claim that no transfer occurred and that a separate \$600,000 wire was considered repayment. The Court called the president's testimony self-serving and relied instead on bank records and the Forms 990 filed at the time. The excess benefit was not corrected before the notice of deficiency was mailed. As a result, the court sustained the imposition of a 25 percent first-tier tax of \$147,500 and the 200 percent second-tier tax of \$1.18 million for a total of \$1,327,500. The Court also imposed additional penalties and taxes under I.R.C. §6651(a)(1) and (2) for failure to file Form 4720 and

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failure to pay, because no reasonable cause defense was raised.

The decision is a reminder for exempt organizations and their insiders on several points. Loans to disqualified persons and their controlled entities carry significant risk under Section 4958, particularly when one person documents both sides of the transaction. Forms 990 filed at the time can be used as evidence against the insider. The disqualified person must personally file Form 4720. Correcting an excess benefit promptly, before a notice of deficiency is issued, is essential to avoid the 200 percent second-tier tax.

Shumaker's Nonprofit & Tax-Exempt team continues to monitor these developments and their potential implications for tax-exempt entities.

For additional information on how these changes may affect your organization, please contact Felix C. Pelzer or Hannah Campbell.