IMPACT OF SECTION 4960 PROPOSED RULES ON TAXABLE AND EXEMPT ENTITIES

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<table>
<thead>
<tr>
<th>Topic</th>
<th>Minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 4960 background</td>
<td>5</td>
</tr>
<tr>
<td>Introduction to the proposed regulations</td>
<td>20</td>
</tr>
<tr>
<td>Remuneration</td>
<td>15</td>
</tr>
<tr>
<td>Excess parachute payments</td>
<td>5</td>
</tr>
<tr>
<td>Tax liability</td>
<td>5</td>
</tr>
<tr>
<td>Reliance</td>
<td>5</td>
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<tr>
<td>Resources</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>60</strong></td>
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</tbody>
</table>
• Volunteer exceptions intended to exclude remuneration paid by related taxable organizations for services unrelated to ATEO
• No excise tax imposed on related organizations for their portion of any parachute payment
• Clear definitions of control, particularly of nonstock organizations
SECTION 4960 BACKGROUND
Law and current guidance

- Section 4960 imposes an excise tax on certain tax-exempt organizations and related taxable, tax-exempt, and government entities
  - Enacted December 22, 2017 as part of the 2017 Tax Act

- Notice 2019-09 provides interim guidance as Q&As
  - Released December 31, 2018

- Proposed regulations provide interim guidance and address open questions
  - Published June 11, 2020
The tax

21% excise tax imposed on:

• **Excess remuneration**
  • *Remuneration* in excess of $1,000,000
  • Paid by an *applicable tax-exempt organization* (ATEO) or *related organization*
  • To a *covered employee*

• **Excess parachute payments**
  • Paid by an ATEO
  • To a covered employee
Applicable tax-exempt organizations

- Section 501(a)
- Section 115(1)
- Section 527(e)(1) – political organizations
- Section 521(b)(1) – farmers’ cooperatives
Related organizations

- **Control**, are controlled by, or under common control of the ATEO
- Supported and supporting organizations
- Organizations that establish, maintain, or contribute to VEBAs
Covered employee

- Current or former employee
  - One of five highest compensated employees of the organization for the taxable year
  - Was a covered employee of the organization or predecessor organization for any preceding taxable year beginning after December 31, 2016

- “Hotel California” rule – Once covered, always covered
• Section 3401(a) wages
• No longer subject to a substantial risk of forfeiture
• Excludes designated Roth contributions (section 402A(c))
• Excludes amounts paid for the provision of medical services by a medical professional
Excess parachute payments

- Amount by which parachute payment exceeds the base amount

- Parachute payment
  - Payment to a covered employee in the nature of compensation
  - Contingent on INVOLUNTARY separation from employment
  - Aggregate present value equals or exceeds 3x the base amount

- Base amount
  - Average annual compensation includible in gross income
  - Using most recent 5 taxable years
INTRODUCTION TO THE PROPOSED REGULATIONS
Contents

- Table of contents (53.4960-0)
- Definitions (53.4960-1)
- Remuneration (53.4960-2)
- Excess parachute payments (53.4960-3)
- Tax liability (53.4960-4)
- Applicability date (53.4960-5)
Definitions

- ATEOs
- Applicable year
- Employee and employer
- Covered employee
- Medical services
- Predecessor
- Related organizations
Questions about ATEOs

• **Are government entities subject to the excise tax?**
  • It depends. Some are subject directly, others indirectly.
  • Need to know whether political subdivision, integral part, or section 115(1).

• **Do I need to worry about foreign organizations?**
  • It depends. Section 4948(b).
  • Does the organization receive substantially all of its support from sources outside the United States? Question about related organizations.
Questions about taxable year

- **What year do I use to determine remuneration and compute the excise tax?**
  - Calendar year ending with or within the tax year.

- **What if I have a short year without a calendar year end?**
  - Include amounts in the preceding or following year that contains a calendar year end.
  - For terminating organizations, compute years separately and aggregate for reporting purposes.
Questions about employees and employers

• **What if all employees are paid through a different entity?**
  • Either treat as related organization remuneration or as paid by the employer.
  • No exceptions for third-party payors.

• **Are officers, directors, and trustees employees?**
  • Directors and trustees are not employees.
  • Officers generally are employees. Exception if they provide minor services and do not receive remuneration.
Questions about covered employees

• Do all organizations have covered employees?
  • No.
  • It is possible to have no or fewer than 5 covered employees in a given year if neither the ATEO nor related organizations compensate their employees.
  • Remember that a determination of covered employees is separate from the excise tax. Important to identify and track or have support for why there are none.

• Do we need to worry about volunteers employed by related taxable organizations?
  • Maybe.
  • The proposed regulations added some volunteer exceptions.
## Volunteer exceptions

<table>
<thead>
<tr>
<th>Exception</th>
<th>Remuneration requirement</th>
<th>Hours &amp; service requirement</th>
<th>Related organizations</th>
<th>Disregarded payments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Limited hours</strong></td>
<td>No remuneration paid by</td>
<td>≤ 10% or 100 hours for ATEO and all related organizations</td>
<td>N/A</td>
<td>Amounts paid by related organization if ATEO does not reimburse</td>
</tr>
<tr>
<td></td>
<td>• ATEO, or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Related ATEO</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Nonexempt funds</strong></td>
<td>No remuneration paid by</td>
<td>&lt; 50% hours for ATEO and all related organizations</td>
<td>Compensating employer did not provide services for a fee to ATEO, related ATEO, or controlled taxable organization</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• ATEO, or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Related ATEO, or</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Controlled taxable organization</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Limited services</strong></td>
<td>&lt; 10% paid by ATEO</td>
<td>N/A</td>
<td>At least one related ATEO paid ≥ 10% or more than ATEO</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Questions about medical services

- **Are administrative tasks considered medical services?**
  - It depends. Are they integral to the performance of medical services?
  - Yes: maintaining patient records
  - No: scheduling, conducting performance evaluations

- **Are medical school professors considered to be providing medical services?**
  - Generally, no.
  - Yes, to the extent they are supervising residents in clinical work or otherwise performing medical services.
• Do covered employees retain their status if acquired through a reorganization or merger?
  • Generally, yes.
  • There are three rules to consider
    • 80% transfer rule
    • 24-month services rule
    • 36-month limitation rule
Questions about related organizations

• **What is control?**
  • More than 50% of
    • Vote or value of stock in a corporation
    • Profits or capital interest in a partnership
    • Beneficial interest in a trust
    • Board control of a nonstock corporation
  • Section 512(b)(13) principles, including section 318 attribution

• **How do we determine board control of a nonstock corporation?**
  • Removal power test
  • Representative test
    • Directors, trustees, officers, employees, agents
    • Exception for low-level employees not serving as representatives
Definitional clarifications

- Remuneration does not include excess parachute payments
  - Generally section 3401(a) wages
  - Amounts paid due to involuntary separation will be included in remuneration if not “excess parachute payments”

- Below-market split-dollar loans (section 7872) are remuneration
  - Even though not subject to withholding

- Section 162(m) disallowed amounts are remuneration whereas payments for provision of medical services are not remuneration
Timing

- Remuneration treated as paid when no longer subject to substantial risk of forfeiture (section 457(f)(3)(B)), even for other types of plans
- No short-term deferral rule
- Payroll tax year-end straddle: supplemental wage v. “regular” wage
  - Example: Pay period ends 12/26/20; paycheck issued 1/2/21
  - Regular wage treated as 2021 remuneration
  - Bonus attributable to 2020 but paid in 2021 is 2020 remuneration

<table>
<thead>
<tr>
<th>Type</th>
<th>SROF</th>
<th>When</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular wage</td>
<td>No</td>
<td>Actual or constructive payment</td>
</tr>
<tr>
<td>Not regular wage</td>
<td>No</td>
<td>First date where right to payment is legally binding</td>
</tr>
<tr>
<td>Not regular wage</td>
<td>Yes</td>
<td>Vesting</td>
</tr>
</tbody>
</table>
Previously paid remuneration

- Amounts vested before constructively or actually paid
- Remuneration includes earnings (and losses) on such amounts
  - Watch earnings and losses after year of vesting
  - Watch present value calculation increases each year

- Unofficial “grandfather” rule
  - No exception for binding, written contracts before date of enactment
  - Amounts vested before application of section 4960, not subject to tax
    - Tax years prior to 2017
    - Remuneration paid prior to becoming an employee
EXCESS PARACHUTE PAYMENTS
Separation from employment

• Can only be a parachute payment if it is contingent on an involuntary separation from employment
  • Includes lapse of substantial risk of forfeiture due to separation
  • Includes acceleration in lapse of SROF or acceleration of payment
  • Includes non-compete payments
  • Watch unexpected “retirements” – truly involuntary? Were unvested section 457(f) amounts vested?

• Use definitions from sections 409A and 457
  • Separation for good reason
  • Bona fide change from employee to independent contractor
  • Reduction in hours safe harbors (< 80% and > 50%)
3x base amount

- Present value of payment is 3x the average annual compensation for 5 most recent taxable years
  - Present value discount is 120% of AFR, compounded semiannually

- Payment in nature of compensation
  - Taxable non-cash fringe benefits
  - Section 83 property
  - Stock options and stock appreciation rights
  - Sabbaticals?
  - Valuation issues
TAX LIABILITY
Liability, reporting, and payment

- Taxpayer (ATEO, related ATEO, related taxable, related government) is liable regardless of any arrangement between organizations regarding who bears the cost of the liability

- Reported on and paid with Form 4720
Calculation

• When more than one employer, generally allocate tax liability in same proportion as remuneration paid by each employer

• If liable as both an ATEO and as a related organization with respect to same employee, pay the greatest amount of excise tax (not both)

• When one organization has a short tax year, must compare liability of related organizations (Example 4)
Excess parachute payments

- Excess parachute payments made by related organizations taken into account for purposes of determining whether there is an excess but related organizations not subject to tax

- Election to prepay excise tax provided that present value is reasonably ascertainable (comes from section 280G regulations)
Options

- Reasonable, good faith interpretation of the statute
- Notice 2019-09
- Proposed regulations

Anticipated effective date of final regulations: taxable years beginning on or after the date published in Federal Register
Not reasonable, good faith interpretation

- Related for-profit or governmental entities are not subject to excise tax
- A covered employee can cease being treated as a covered employee
- Determine covered employees by including payment for the provision of medical services
- A group of related ATEOs can only have 5 highest compensated employees
RESOURCES
Further reading

- **RSM Tax Alert** (published June 10, 2020)
- **Proposed regulations**
- **Notice 2019-09**