Bloomberg Tax

Tax Management
Compensation Planning Journal™

Executive Compensation for Tax-Exempt Organizations Under the Final Regulations

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OVERVIEW

Among other developments that have made 2021 a unique year, in the area of tax laws governing tax exempt entities' executive compensation we received the finale to the guidance under §4960[1] which followed the proposed regulations[2] in 2020, and 2019's lengthy Notice providing further definition to the unpleasant surprise for tax exempt organizations enacted in the Tax Cuts and Jobs Act[3] enacted in late 2017 (the "2017 Tax Act"). The 2017 Tax Act surprised tax-exempt organizations when it imposed a 21% excise tax on compensation in excess of $1 million and on certain "parachute payments" and the subsequent guidance works to explain the new law which builds on existing tax concepts, with some modifications.

Organizations subject to §4960 include public universities, state and local government entities, charitable organizations, public utilities, farmers' cooperatives, and other organizations operated without an expectation of retaining profits to pay tax expenses may now find themselves subject to either complying with the new compensation limit, or adjusting planned use of financial resources in order to free funds to pay the tax.[4] While the 2017 Tax Act's changes to the compensation limit for companies with publicly traded securities included a transition rule,[5] surprisingly, the addition of this compensation limit to entities that had not faced this type of hard line limit did not provide for any explicit transition rule[6] for existing contracts. Since there is no statutory transition rule, the entities subject to this excise tax may have had an immediate unplanned expense. Notice 2019-9 provided some relief in the parachute payment area by recognizing the impact special substantial risk of forfeiture requirements applicable to the tax-exempt organization under §457(f) as explained herein. Proposed regulations were issued on June 11, 2020. The Final Regulations[7] were issued on January 19, 2021.[8] This article cites to only the Final Regulations and will note differences from the proposed regulations only when the authors consider it to be a substantial change from the proposed regulations. The proposed regulations cease to be applicable for taxable years beginning on or after December 31, 2021. For taxable years beginning prior to December 31, 2021, and after December 31, 2017,

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[1] All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[2] 85 Fed. Reg. 35,746 (June 11, 2020).

[3] Pub. L. No. 115-97.

[4] See potential limitations on the application of §4960, as added by the 2017 Tax Act, to state and local government run universities explained further in "Organizations Subject to the Compensation Limit and Excise Tax" below.

[5] 2017 Tax Act, §13601(e).

[6] 2017 Tax Act, §13601(e).

[7] 86 Fed. Reg. 6196 (Jan. 19, 2021) (as amended by 86 Fed. Reg. 23,865 (May 5, 2021)).

[8] Fix this

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a taxpayer may elect to apply the Final Regulations, provided the Final Regulations are applied in their entirety.[9]

Section 13602 of the 2017 Tax Act added §4960, which imposes a tax on what it deems to be excess executive compensation in tax-exempt organizations. Section 4960 borrowed concepts from restrictions applicable to for profit companies, such as the compensation limit under §162(m), the golden parachute limitations under §280G, and the related tax under §4999. However, these rules differ in many respects and the penalties are revised to fit the different type of organization with an excise tax applicable to the entity for either a violation of the compensation limit or for the excess departure payments upon an involuntary separation from service[10] (because the change in control concepts under §280G and its tax on the individual do not fit as well). The tax falls on excess compensation paid in any tax year above $1 million, plus it can also apply to any of what it calls an ''excess parachute payment'' paid to a covered employee upon separation from employment with the entity subject to the tax. The $1 million dollar threshold does not apply to any amounts which are excess parachute payments.[11]

As a practical matter, tax exempt organizations will need to watch the payments triggered by an involuntary separation from employment to keep that amount at a multiple of 2.99 or less of the ''base amount.'' Organizations who compensate the covered employees at an annual amount that exceeds the one million dollar limit will need to budget for the excise tax on the compensation the tax-exempt organization pays the executive above the annual limit. Affected tax exempt and governmental employers will also need to maintain lists of which individuals are amongst the ''High Five'' in each calendar year after December 31, 2016, since the excise tax follows the change to §162(m) by adopting a ''once-in-always-in'' rule.

While some terminology in §4960 is similar to that used in §162(m) and §280G, the terminology in §4960 is defined in different ways from the restrictions on a company that has publicly traded securities or that is subject to §280G's golden parachute rules. Thus, one needs to carefully review the §4960 definitions and anti-avoidance rules to fully appreciate its scope and application.

RELATED ORGANIZATIONS WITH PUBLICLY TRADED SECURITIES

There is a unique provision that appears to be intended to coordinate §162(m) with §4960 to preclude the same compensation being subjected to both a loss of deduction and an excise tax, which would effectively tax the same amounts twice. This provision applies to compensation determined to be nondeductible under §162(m) in a ''related organization'' to a tax exempt entity from also being subject to the excise tax under §4960 when the individual's pay is aggregated because it is paid by a ''related organization.''[12] This appears to be intended to operate to prevent double taxation if a company with publicly traded securities also had a tax-exempt foundation that was a ''related'' organization and the CFO of the publicly traded company was also a member of the High Five for an applicable tax-exempt organization (ATEO) and received compensation in excess of $1 million from the publicly traded company and also receive compensation from the tax-exempt organization. Once an amount of compensation is not deductible, then such amount is not taken into account or subject to the excise tax under §4960 rule.[13] However, this provision does not expand the amounts of compensation that can be paid to top individuals by utilizing multiple related entities. It is important to remember that the individuals subject to §162(m) may not be the same as the High Five (see definition below) subject to §4960 if a company with publicly traded securities is aggregated with a tax-exempt foundation as ''related organizations.'' See below for the discussions in the section on ''Related Organizations.'' Which entities may be ''related organizations'' must be defined under §4960(c)(4)(B) and under §4960(d) which grants the IRS authority to promulgate regulations necessary to prevent avoidances including to prevent providing compensation through a separate entity, compensation provided to a person in a capacity other than as an employee or by providing compensation through a pass-through entity or other entity to avoid tax. Perhaps those other entities providing pay were intended to capture pay from loosely affiliated entities or other entities providing pay for the executives.

The individuals impacted by the 2017 Tax Act may differ from the §162(m) employees (as revised by the 2017 Tax Act). Please also see the section below on the ''Special Rule for Entities with Publicly Traded Securities and a Charitable Foundation.'' Section 162(m) has its own aggregation rules for entities subject to its provision solely as the result of its issuance of publicly traded securities by looking to the definition of affiliated groups under §1504 (determined

[9] Reg. §53.4960-6.

[10] Notice 2019-9 Q&A 20(a);86 Fed. Reg. 6196, 6210-6212 (Jan. 19, 2021).

[11] §4960(a).

[12] §4960(c)(3)-§4960(c)(4); 4960(c)(6); Notice 2019-9, Q&A 38.

[13] §4960(c)(3)-§4960(c)(4); §4960(c)(6); Notice 2019-9, Q&A 38.

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without reference to subsection §1504(b)).[14] Separate aggregation rules apply to entities subject to the Troubled Asset Relief Program and certain health insurance providers that utilize the rules for controlled groups under §414(b), §414(c), §414(m), or §414(o). The aggregation of entity rules apply to determine if the individual is employed by a single employer, which involves different aggregation rules than those used for §4960.[15] Selection of the correct aggregation rules for the particular tax provision will be critical.

The aggregation rules for §162(m) for calculating remuneration paid subject to the deduction limitation may differ by the types of entities and may result in inclusion of different entities than those covered by the §4960 aggregation rules when those rules are applied to the entity's related charitable foundation. While compensation is not deductible under §162(m) for some individuals, those may not be the same individuals subject to the §4960 excise tax when the §4960 ''related organizations' are aggregated. Thus, there may be exposure for the excise tax in related foundations if the related foundation employs some of the same employees as the taxable corporation with publicly traded securities.

WHO IS LIABLE FOR THE §4960 EXCISE TAX?

An ATEO must have covered common law employees to be potentially subject to §4960 excise tax. If the ATEO's High Five employees (including High Fives from prior years) are also employed by entities that qualify as related organizations to the ATEO under §4960(g), then the ATEO and each related organization that also employs one of the High Five are each liable for their portion of the §4960 excise tax.[16]

ORGANIZATIONS SUBJECT TO THE COMPENSATION LIMIT AND EXCISE TAX – WHO IS AN ATEO?

Tax-Exempt Charitable Organizations and Certain Employee Benefit Plan Trusts

The new limit applies to many different types of organizations which constitute an ATEO. It applies to all tax- exempt entities under §501(a),[17] which includes all §501(c) and §501(d) tax-exempt entities, and all qualified retirement plans under §401(a). The new limit also applies to all voluntary employee beneficiary associations (VEBAs) that may be funding employee benefits and to all multiemployer plans that are qualified retirement plans under §401(a) or that may be maintained by a union for multiple employers, or for a single employer under §501(c)(9) as a VEBA.

Farmers' Cooperatives

The new law also applies to farmers' cooperatives under §521(b)(1), which includes organizations of farmers, such as dairy farmers, fruit growers, and like associations that are operated on a cooperative basis for purposes of marketing the products of the members or other producers and returning to those farmers or producers the proceeds of the sales less necessary marketing expenses based on either the quantity or value of the products furnished by the respective farmers and fruit growers. A farmer's cooperative may also cooperate for the purpose of purchasing supplies and equipment for the use of the various members at cost plus necessary expenses.[18]

Political Organizations

The new law also applies to political organizations, including every political organization under §527(b)(1), without any exclusions. In a political organization context, it applies to a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of, directly or indirectly, accepting contributions or making expenditures, or both, for the purposes of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office, and to a political organization for the selection of presidential or vice-presidential electors.[19]

Potentially Certain Governmental Organizations with Income Excludable from Federal Income Tax

The new law also purports to apply to any governmental organization, which would include a public utility or an entity that exercises any essential governmental function including a state or any public political subdivision thereof or the District of Columbia.[20] To the extent a state university or college is organized as a political subdivision of the state, it might apply,

[14] Reg. §1.162-27(c)(1)(ii).

[15] §162(m)(5)(B)(iii), §162(m)(6)(C)(ii).

[16] Notice 2019-9, Q&A3; Reg. §53.4960-4.

[17] Reg. §53.4960-1(b)(1)(i).

[18] Reg. §53.4960-1(b)(1)(ii).

[19] §527(b)(1), §527(e); Reg. §53.4960-1(b)(1)(iv).

[20] §115(1).

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if there is no technical correction to the 2017 Tax Act, or if its application is not challenged under the doctrine of implied statutory immunity.[21] Notice 2019-9 clarifies that a governmental entity (including a state college or university) that is not recognized as tax exempt under §501(a) and which does not exclude income from gross income under §115(1) is not an ATEO.[22] The doctrine of implied statutory immunity comes into play. Any university or college that is organized as a tax-exempt charitable organization is subject to the new limitation, as well as the supporting foundation for the university or college. There are no final regulations issued under §115 providing guidance on the scope of the organizations covered. If a state college or university is not tax exempt under §501(a) and it does not exclude income under §115(1), it is not an ATEO and is not subject to §4960.[23]

A government entity that is separately organized from a state or political subdivision may meet the requirements to exclude income from taxation under §115(l). However, if such governmental entity does not meet the requirements to be able to exclude income under §115(1), then because §115(1) does not apply to exclude its income from taxation because the state is not directly conducting such activity, then the organization if it is not tax exempt under §501(a), would not be an ATEO subject to §4960. If a governmental unit does not have a determination letter that it is tax exempt under §501(a) and it does not exclude income under §115(l), it is not an ATEO, unless it is a related organization.[24] A governmental entity that has a determination letter under §501(c) may relinquish its §501(c)(3) status by following certain procedures.[25]

There are certain foreign organizations described in §4948(b) that are either tax exempt under §501(a) or which constitute a private foundation that are not ATEOs.[26] Such entity must not have been created or organized in the U.S., any state, the District of Columbia or a U.S. possession.

It is rumored that certain athletic goods manufacturers and other businesses have suggested that they might pay the compensation above the $1 million limit to coaching staff at certain colleges and universities. Those parties will need to also consider any potential implication of such payment under not only §4960's anti-avoidance provision in §4960(d) and whether such payment will still be treated as ''remuneration'' paid by another organization ''with respect to an employee's employment by an ATEO''[27] and thus subject the ATEO to the excise tax, but also under the applicable NCAA rules and whether such a payment might make the business making such payment a ''Representative of Athletics Interests'' with respect to the college or university and thus make the payer subject to the rules contained in the applicable NCAA Manual as a ''Representative of Athletics Interests'' or a booster, including for example, the restrictions on recruiting of student athletes and contacts with such student athletes.[28] A college or university can request an interpretation from the NCAA on particular factual situations under the NCAA Manual rules. Colleges and universities should review the anti-avoidance regulations authorized under §4960(d) and the related organization definition under §4960(c)(4)(B) and any guidance under such subsections to define what facts might fall within the related organization definition or the anti-avoidance rules.

The organizations subject to this new limit are a broad group of organizations and would include not only brick and mortar churches and tax-exempt

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[21] State immunity from federal taxation has been recognized where the state function being performed is an activity that is essential to the preservation of the state government, *Helvering v. Gerhardt*, 304 U.S. 405 (1938); however, the immunity does not extend to the operation of state-run liquor stores wherein the Supreme Court found that the ''state itself, when it becomes a dealer in intoxicating liquors, falls within the reach of the tax either as a 'person' under the statutory extension of that word to include a corporation, or as a 'person' without regard to such extension,'' *Ohio v. Helvering*, 292 U.S. 360 (1934). The Internal Revenue Service has also analyzed the application of §115(1) and found that not all income of a state university is exempt under such section excluding income earned by the university from providing utility and hotel services to the general public as not being covered by the doctrine of intergovernmental tax immunity, GCM 37657 (1978); and in *Troy State University v. Commissioner*, 62 T.C. 493 (1974), the Tax Court found that the university received a charitable contribution of the stock of an entity owning a hospital, the university then caused the company to be liquidated and it received all of the hospital's assets and the university did not recognize any gain from the liquidation or sale of the underlying assets and argued that the U.S. Constitution impliedly prohibited a tax on the university because it was an instrumentality of the State of Alabama. The Tax Court analyzed the claim of immunity under the two guiding principles from *Helvering v. Gerhardt*, and stated that ''One of these principles excludes from the immunity activities thought not to be essential to the preservation of state governments'' and also found that it failed for an additional principle as well. *Troy State University*, 62 T.C. 493 at 502.

[22] Notice 2019-9; Reg. §53.4960-1(b)(1)(iii)

[23] Note 2019-9; and Q&A 5 and 6; Reg. §53.4960-1(b).

[24] Notice 2019-9, Q&A 5; 86 Fed. Reg. 6196 (Jan. 19, 2021).

[25] Notice 2019-9, Q&A 6.

[26] Reg. §53.4960-1(b)(2).

[27] Notice 2019-9, Q&A 12(c); Reg. §53.4960-3(b).

[28] 2017-2018 NCAA Division I Manual, sections §13.02.15 (defining ''Representative of Athletics Interests''), which term is then used for example in §13.01.1 (Eligibility Effects of Recruiting Violations) and §13.1 (Contacts and Evaluations). The recent change permitting college athletes to be able to earn from use of their name or likeness and may impact the booster rules, but such changes are beyond the scope of this article.

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healthcare systems, but also large universities that are tax-exempt charitable organizations, farm cooperatives, political organizations, and maybe certain aspects of state or local political subdivisions not engaging in traditional essential government functions. It also includes related organizations as explained below.

IMPORTANT CONCEPTS FOR §4960 – APPLICABLE YEAR

Important Concept – Applicable Year

The applicable year is the calendar year ending with or within the ATEO's taxable year and it is the year during which remuneration is measured for a covered employee to determine the tax on the ATEO. The applicable year is the calendar year in which a covered employee's remuneration is measured for the §4960 tax for the tax year of the ATEO in which the applicable year ends.[29] The applicable year is the calendar year of the covered employee. The applicable year is used to calculate the tax due.

The excise tax can apply to remuneration paid to a covered employee in excess of $1 million annual limit, measured on the applicable year, or paid to a covered employee in the event of termination of employment. However, it is important to note that compensation paid and considered for the tax under the annual limit tax is not then also considered for the excise tax on a parachute payment and vice-versa.

Important Concept – Remuneration Paid for a Taxable Year

Remuneration paid in a taxable year starts with wages as defined under §3401(c), but excluding Roth contributions and including any amounts required to be included in gross income under §457(f) (e.g., nonqualified deferred compensation which vests for when the substantial risk of forfeiture lapses, or a long-term incentive plan where the continued employment condition is satisfied).[30] Remuneration does include any amounts of imputed income imposed on a covered employee because the covered employee received a loan from the ATEO at a below-market interest rate for a loan in excess of $10,000.[31] If a covered employee had deferred compensation that was vested or paid prior to the covered employee's first taxable year that began on or after January 1, 2018, such amounts are not included in a covered employee's remuneration.[32] Remuneration paid to a licensed medical or veterinary professional for medical or veterinary services are excluded.[33]

The 2017 Tax Act exempts the compensation paid for medical or veterinary services to a licensed medical or veterinary professional from the compensation subject to such limitation, so compensation paid to doctors and veterinarians for professional services can exceed the limit without triggering the excise tax.[34] Remuneration qualifies as paid for medical or veterinary services if it is paid for the direct performance of medical (including nursing) or veterinary services. This is focused on the pay to the individual employee and not on how the employer receives payment related to such individuals' services.[35] This is significant because such remuneration for medical or veterinary services is excluded from (1) determination of whether the recipient is amongst the High Five; (2) calculation of pay in excess of One Million Dollars; and (3) from determining if such pay is part of a parachute payment.[36] The individual must be licensed to provide such services under state or local laws. Medical services includes diagnosis, cure, mitigation, treatment, prevention of disease, including services affecting any structure or function of the body and documenting the care and condition of the patient constitutes medical services[37] as does accompanying another licensed professional as a supervisor while the other provides medical services constitute medical services for this purpose.[38] However management of the organization's operations, including scheduling, appraisal, teaching, or research are not medical services.[39] Similarly, analyzing the budget and managing human resources are not integral to providing medical services.[40] However, some teaching constitutes medical services such as overseeing and teaching a group of resident physicians who have medical licenses which are limited or restricted in what they can do constitutes medical services.[41]

If an employer pays a covered employee for medical services and other services, the employer must make a reasonable good faith allocation of the remuneration, but if an employment agreement sets forth

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[29] Reg. §53.4960-1(c), Reg. §53.4960-4.

[30] Reg. §53.4960-2(a).

[31] Reg. §53.4960-2(a).

[32] Reg. §53.4960-2(a)(1).

[33] Reg. §53.4960-2(a)(2).

[34] §4960(c)(3)(B).

[35] Notice 2019-9, Q&A 15; Reg. §53.4960-2(a)(1).

[36] Notice 2019-9, Q&A 15(a); Reg. §53.4960-2(a)(2), Reg. §53.4960-3(a)(2) .

[37] Reg. §53.4960-1(g)(1)(ii)(A).

[38] Reg. §53.4960-1(g)(1)(i).

[39] Notice 2019-9, Q&A 15(c); Reg. §53.4960-1(g)(1)(i)

[40] Reg. §53.4960-1(g)(1)(ii)(B).

[41] Reg. §53.4960-1(g)(1)(ii)(C).

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the pay for medical services and for administration services, that allocation must be followed for §4960 unless the facts and circumstances demonstrate the allocation is unreasonable.[42] Since this tax only applies to the ATEO, the ATEO must take the initiative to provide an allocation in employment agreements of medical or veterinary professionals who may be part of the High Five group.

THE HIGH FIVE – WHO IS SUBJECT TO THE REMUNERATION LIMIT?

The individual must be among one of the ATEO's five highest paid employees ranked by remuneration paid in the applicable year or among the five highest paid employees in a prior year subject to §4960.[43] The employees whose remuneration may potentially trigger this new tax are the five highest compensated employees of the organization (High Five) in the current applicable year and any employee who was ever in the High Five in any applicable year after December 31, 2016, or a person who was a High Five at a predecessor entity.[44] It is interesting that it does not require these individuals to continue to be executives of the organization, but only requires them to be one of the five most highly compensated employees of the organization for the applicable year or in a prior year after December 31, 2016. The individual must be an employee of the ATEO to be a potential covered employee.[45]

An individual can also be a covered employee if the individual was in the High Five of that organization or a predecessor of that organization for any preceding applicable year that begins after December 31, 2016.[46] For an individual who terminated in 2017, they could still be treated as a covered employee if they were still receiving pay in 2018 from the organization[47] or if they were an individual who was a High Five individual in 2017.[48] Remuneration paid by all related organizations is aggregated to determine the tax on excess annual remuneration, and Notice 2019-9 and the Final Regulations clarify that remuneration is also aggregated to determine which individuals fall within the High Five for the applicable year for the ''ATEO'' based on the remuneration paid by the ATEO and related organizations during the ''applicable year.''[49]

The remuneration paid for medical or veterinary services is not taken into account to identify the High Five (further explained below).

An ATEO may exclude from the High Five certain employees who may be disregarded employees for High Five calculation for the ''applicable year'' provided neither the ATEO or the related organization paid remuneration or granted a legally binding right to non-vested remuneration to the covered employee for services performed as an employee.[50] An ATEO may also disregard an individual if such individual meets all of the requirements for the Limited Hours exception.[51] An individual who qualifies for the nonexempt funds exception may also be disregarded in the High Five determination.[52] An individual qualifies for the Limited Service Exception may also be excluded from the High Five determination.[53] Separate rules apply when part of the remuneration is an amount for which a deduction was disallowed under §162(m).[54] The Final Regulation clearly treats the Limited Service exception as only applicable to the remuneration paid by an ATEO.[55] The source of the remuneration is not relevant to the limited services exception, but whether the individual received any remuneration for minor services as an officer of an ATEEO regardless of the source of the remuneration.

If less than 10% of the employee's total remuneration in the year for services is paid by the ATEO and all related organizations of the ATEO, then the employee is not one of the High Five for that year. If such employee would not be one of the High Five of any ATEO in the ATEO's groups of related organization because no ATEO in the group paid at least 10% of the total remuneration paid by the group during the calendar year, then this exception does not apply to the ATEO that paid the employee the most remuneration during that calendar year (the ''Limited Service Exception'')[56] and such individual is treated as employed by such ATEO and such ATEO must include the individual in its High Five.[57]

Nonexempt funds exemption from covered employee status disregards an employee from covered employee status if (1) neither the ATEO nor any re-

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[42] Reg. §53.4960-1(g)(1)(ii)(C).

[43] Reg. §53.4960-1(d)(2).

[44] §4960(c)(2) and Notice 2019-9, Q&A 9; Reg. §53.4960-1(d)(1).

[45] Reg. §53.4960-1(d)(1).

[46] Notice 2019-9, Q&A 9; Reg. §53.4960-1(d)(1), Reg. §53.4960-1(d)(2).

[47] §4960(c)(2).

[48] §4960(c)(2)(B).

[49] Notice 2019-9, Q&A 10; Reg. §53.4960-1(d)(2).

[50] Reg. §53.4960-1(d)(2)(i).

[51] Reg. §53.4960-1(d)(2)(ii).

[52] Reg. §53.4960-1(d)(2)(iii).

[53] Reg. §53.4960-1(d)(2)(iv).

[54] Reg. §53.4960-1(d).

[55] 86 Fed. Reg. 6196, 6197 (Jan. 19, 2021).

[56] Notice 2019-9, Q&A 10(b); §53.4960-1(d)(2)(ii).

[57] Notice 2019-9 Q&A 10; Reg. §53.4960-1(d)(2)(ii).

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lated organization under the ATEO's common control either alone or together with the related ATEO paid remuneration or granted a legally binding right to compensation to the individual for services performed for the ATEO in the applicable year, (2) the individual performed services as an employee of the ATEO for not more than 50% of the total hours worked as an employee of the ATEO or any related organization during the applicable year, and (3) no related organization that paid remuneration or granted a legally binding right to nonvested remuneration to the individual during the applicable year and the preceding applicable year provided services to the ATEO or a related organization controlled by the ATEO or any taxable related organization alone or together during the applicable year or preceding applicable year.[58]

The covered employee definition and the related tax on excess remuneration could impact executives from large healthcare systems or coaches from universities. In addition, it could impact anyone else who was highly paid from one of the organizations specified as subject to the limit. This differs from §162(m)'s similar limit on the deduction of compensation, as modified by the 2017 Tax Act, which applies to the principal executive officer and principal financial officer and the three highest paid officers who are not in one of the two named positions.[59]

ONCE IN THE HIGH FIVE, ALWAYS SUBJECT TO §4960

If an employee or former employee of the entity subject to this new restriction is part of the High Five group any time after December 31, 2016, for this entity or a ''predecessor entity,'' then that individual is always subject to the excise tax and compensation limit.[60] In acquisitions or mergers of exempt organizations subject to this limit, a new item must be added to the due diligence checklist or the transition checklist, to obtain such entity's list of persons subject to the High Five limit.[61] A ''predecessor'' in an asset acquisition occurs when an ATEO acquires at least 80% of the operating assets or total assets of another ATEO then the target entity is a predecessor of the acquiring ATEO.[62] The 80% is calculated considering only assets acquired within a 12-month period. A predecessor also includes a separate ATEO whose assets or stock/membership interests are acquired in the tax free corporate reorganizations under §368(c)(1)(A), §368(c)(1)(C), §368(c)(1)(D), §368(c)(1)(E), §368(c)(1)(F), or §368(c)(1)(G). An ATEO which is restricted changing its organizational form or place of organization is a predecessor of the reorganized ATEO.[63] An organization that is an ATEO and then ceases to be an ATEO and again becomes an ATEO on or before a date that is 36 months following the due date for filing the organization's tax return as an ATEO for the last taxable year the organization was previously an ATEO.[64] Additional considerations related to being a predecessor to an ATEO are included in the Final Regulations. A predecessor must have been an ATEO at the time the employee was employed by the predecessor.[65]

REMUNERATION COUNTED TO DETERMINE IF IN HIGH FIVE AND TOWARD NEW LIMIT

While the new limitation pulls in all covered employees, not all covered employees' pay is used to define the five most highly paid individuals. However, remuneration paid by the ATEO and by a related organization are combined to determine the amount in excess of One Million Dollars.[66] The ''remuneration'' subject to the excise tax includes wages subject to income tax withholding under §3401(a) (excluding Roth contributions) and it includes amounts included as income when the substantial risk of forfeiture under §457(f) lapses.[67] Remuneration does not include payments from a qualified retirement plan, annuity plan, or an eligible deferred compensation plan under §457(b).[68] The ''remuneration'' subject to the new excise tax excludes pay that is paid to a licensed medical professional, including a veterinarian, provided it is for the performance of medical or veterinary services by such individual.[69] This means that for a healthcare system, the most highly paid doctors employed by the healthcare system would not be subject to the limitation and excise tax, unless such individual's pay is not for medical services, e.g., when they are paid for hospital management services.

All pay that is treated as wages is included in the compensation calculated toward the new limit. The pay subject to the new $1 million limit excludes des-

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[58] Reg. §53.4960-1(d)(2)(iii).

[59] §162(m)(3).

[60] .§4960(c)(2)(B).

[61] All references to the High Five hereafter refer to those persons determined to be a member of the High Five in the current year and all persons who were determined to be in the High Five in any prior year and with any predecessor entity.

[62] Reg. §53.4960-1(h)(1).

[63] Reg. §53.4960-1(h)(2), Reg. §53.4960-1(h)(3).

[64] Reg. §53.4960-1(h)(4).

[65] 86 Fed. Reg. 6196, 6202 (Jan. 19, 2021).

[66] Notice 2019-9, Q&A 11; Reg. §53.4960-2(a).

[67] Notice 2019-9, Q&A 12(a); Reg. §53.4960-2(a).

[68] Notice 2019-9, Q&A 12(b); Reg. §53.4960-2(a).

[69] §4960(c)(3)(B); Notice 2019-9, Q&A 12; Reg. §53.4960-1(g).

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ignated Roth contributions (which are taxed to the individual and included as compensation paid on a Form W-2, but which are deposited in a qualified retirement plan).[70] The compensation subject to the limit includes all non-qualified deferred compensation paid to such individuals or that is required to be included in the individual's income subject to federal tax under §457(f) when it vests and is no longer subject to a substantial risk of forfeiture.[71] The guidance provides detailed rules regarding when remuneration losses on deferred compensation are recognized.[72] It also provides a rule for remuneration that was vested but not actually or constructively paid as of the close of the taxable year preceding the first taxable year in which §4960 is effective for the employer which treats such amount as if they were paid in the preceding taxable year and not subject to §4960. So deferred compensation balances or accruing as of December 31, 2017, which were still subject to a substantial risk of forfeiture should be documented as such amounts should not trigger a §4960 tax when the forfeiture lapses or they are paid.[73] Special rules exist for fiscal year employers.

The total pay that an individual receives from the tax-exempt entity and that is tested against the $1 million limit includes not only the pay that comes from the primary employer, but also includes pay from any related organizations.[74] However, what constitutes a ''related organization'' raises a number of questions. The remuneration subject to the tax is all remuneration paid by all ''related organizations.'' Thus, which entities are considered ''related organizations'' must be determined under §4960(c)(4)(B).

Remuneration can also include amounts paid by an unrelated organization which is paid with respect to an employee's employment by an ATEO.[75]

Remuneration is ''Paid'' if it is paid during the calendar year ending with or within the employer's tax year and it is counted as paid when it is paid as a part of regular wages under Reg. §31.3102(g)-(1)(a)(1)(ii).[76] Remuneration is paid as of the first day it is not subject to a substantial risk of forfeiture under §457(f)(3)(B), which requires that entitlement to the funds must be conditioned on future performance of substantial services or upon occurrences of a condition related to purpose of the remuneration.[77] Only the present value of future payments to which the individual has a legally binding right is treated as paid during the applicable year and thus is determined on an employer by employer basis.[78] Earnings and losses on previously paid remuneration is determined for each employee and on the net aggregate basis for each employee for all plans maintained by the employer.[79]

RELATED ORGANIZATIONS AGGREGATED TO DETERMINE ''REMUNERATION SUBJECT TO LIMIT'' AND SUBJECT TO THE EXCISE TAX

Instead of borrowing from existing definitions of controlled groups or related parties already contained in the I.R.C., the new limitation and excise tax instead set up a new definition of what constitutes a ''related organization'' where the compensation paid to an individual must be aggregated for purposes of the $1 million limit. Related organizations include any organization that controls or is controlled by the organization paying the compensation (e.g., a hospital that is the sole member of a subsidiary that provides nursing home services). The related organization also includes an organization that is controlled by one or more persons that also control the organization paying the individual (e.g., a local chapter of a charity that is controlled by the national charity that appoints all of its board members).

For purposes of determining which organizations are related, the statute refers to organizations controlled by the ATEO and to organizations controlling the ATEO. Control, while not defined in the statute, was defined in Notice 2019-9 and in the proposed regulations overall without changes[80] as follows:

> (1) for a stock corporation, it means ownership by (vote or value) of more than 50% of the stock of such corporation;
>
> (2) for a partnership it is ownership of more than 50% of the profits interests or capital interests in such partnership;
>
> (3) for a trust which has beneficiaries with beneficial interests it means ownership of more than 50% of the beneficial interests in the trust; and
>
> (4) for non-stock organizations, it is more complicated because individuals or entities do not

[70] Reg. §53.4960-2(a).

[71] §4960(c)(3); Notice 2019-9, Q&A 12; Reg. §53.4960-1(d)(2)(i); Reg. §53.4960-2(a).

[72] Notice 2019-9, Q&A 13; Reg. §53.4960-2.

[73] Notice 2019-9, Q&A 13(e)(iii); Reg. §53.4960-2(a)(1).

[74] §4960(c)(4); Reg. §53.4960-2(b).

[75] Notice 2019-9, Q&A 12(c); Reg. §53.4960-2(b)(1).

[76] Notice 2019-9, Q&A 13; Reg. §53.4960-2(c).

[77] Reg. §53.4960-2(c)(2).

[78] Notice 2019-9, Q&A 13(b); Reg. §53.4960-2(c)(2), Reg. §53.4960-2(c)(d).

[79] Reg. §53.4960-2(d).

[80] 86 Fed. Reg. 6196, 6203 (Jan. 19, 2021).

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own it or have beneficial interests in a nonstock not for profit organization. This includes control with respect to a governmental entity. In the case of nonstock entities, control exists if (a) more than 50% of the directors or trustees of the potential ATEO related entity are either representatives of, or are directly or indirectly controlled by the ATEO or by persons in control of the ATEO, (e.g., 50% of the potentially related organizations directors are also 50% of the directors of the ATEO or vice versa; or (b) more than 50% of the directors of the potentially related organization are either representatives of, or are directly or indirectly controlled by one or more persons that control the ATEO (e.g., the ATEO's CEO has the power to appoint and remove 51% of the directors of the potentially related organization).[81]

For stock organizations, the constructive ownership rules under §318 apply to determine control of stock organizations.

A related organization also includes an organization that is a supported organization (as defined in §509(f)(3) during the taxable year with respect to the organization paying the compensation), e.g., a foundation for a healthcare system or a foundation for a university. The pay from a foundation supporting a university would have its pay to such individual aggregated with the pay paid by the university it supports. The definition of related organization also covers an organization that is a supporting organization during the year under §509(a)(3) with respect to the organization paying the compensation (e.g., the foundation for a church that supports the church that employs the individual).

A related organization includes a VEBA under §501(c)(9). The organization that establishes, maintains, or makes contributions to a VEBA is also a related organization to such VEBA.[82] For example, this might mean an employer that signed the collective bargaining agreement with a union maintaining a VEBA to provide health and welfare benefits to the members of the union would be aggregated with the VEBA and its employees.

The related organizations pick up many affiliated organizations. For a VEBA, the ''related organization'' concept could include all of the sponsoring employers with respect to the VEBA. For instance, a VEBA for a multiemployer plan sponsored by a union (also known as a Taft-Hartley Plan) would include all of the employers making contributions to such VEBA (however, the contributing employers may change over time, so when the related status is determined and for how long it controls the status will need to be defined).

RELATED ORGANIZATIONS UNDER THE FINAL REGULATIONS

Related organizations under the Final Regulations as an entity that meets one of the following tests:

(1) Controls or controlled by test – the entity is a person or governmental entity that controls or is controlled by an ATEO;

(2) Controlled by same person test – the person or governmental entity is controlled by one or more persons that control the ATEO;

(4) Supporting organization test – the person or governmental entity is a supporting organization described in §501(c)(a)(3) with respect to the ATEO; or(3) Supported organization test – the person or governmental entity is a supported organization as defined in §509(f)(3) with respect to the ATEO;

(5) VEBA – if the ATEO is a VEBA under §501(c)(9), the person or government, or entity that established maintained, or made contributions to said VEBA.[83]

For purposes of establishing an entity's control directly or indirectly over another organization, the principles of §318 apply. For a stock company ownership of more than 50% of the stock in a stock corporation's control.[84] For a partnership ownership of 50% or more of the profits, interests or capital interests in the partnership. For a trust ownership of 50% or more of the beneficial interests of the trust by actuarial valuation. For brother/sister related organizations not are related due to both entities being controlled by the same group of individuals electing their board members can also be related organizations.[85] Special rules exist for nonstock organizations and rules related to attribution of ownership were also added. Some revisions were made with respect to the §318 attribution of ownership rules in the Final Regulations.

EXCISE TAX ALSO APPLIES TO EXCESS PARACHUTE PAYMENTS

Not only is compensation above $1 million in a taxable year paid to one of the High Five subject to the excise tax, excess parachute payments are also subject to the new excise tax. While a parachute payment

[81] Notice 2019-9, Q&A 8; Reg. §53.4960-1(i).

[82] §4960(c)(4)(B)(i)-(v); Reg. §53.4960-1(i).

[83] Reg. §53.4960-1(i)(1).

[84] Reg. §53.4960-1(i)(2).

[85] Reg. §53.4960-1(i)(2)(vi).

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sounds very similar to golden parachute payments under §280G, there are new definitions contained in §4960. Under §4960, the trigger is pay that is paid upon separation from employment, not a ''change in control'' as under §280G. Section 4960 also follows §280G but differs because there is no parallel penalty on the employees who are covered employees, unlike disqualified individuals under §280G who are subject to the penalty under §4999. Some of these new concepts or new definitions seem very similar to prior concepts under §280G. Separation from employment is defined generally in the same manner as separation from service under Reg. §1.409A-1(h) without considering the rules for independent contractors.[86] However the employer may not set the level of services reduction in the future to define when the separation is triggered in the same way it can be done under §409A, instead the defaults in such regulation apply.[87] The Final Regulations define an excess parachute payment as a payment in the nature of compensation made by an ATEO (or a predecessor of the ATEO) or a related organization if the payment is contingent on the employee's separation from employment, and the aggregate present value of the payments in the notice of compensation to or for the benefit of the employee that are contingent on separation from employment to the extent such payment equals or exceeds an amount equal to three times the employee's base amount.[88]

Notice 2019-9 limited the application of §4960 to involuntary separations from service because nonqualified deferred compensation of tax exempt and governmental employers is subject to §457(f) which requires such amounts to be subject to a substantial risk of forfeiture to preclude the inclusion of such amounts in income. For example, a substantial risk of forfeiture would exist by requiring the amount to not be payable until a condition outside of the employee's control to occur or continued service to be required. If the payment was under the employee's control, it was vested and already taxable to the employee. Thus, it would have been excluded from remuneration under Notice 2019-9, Q&A 14 because it would have been previously taxable to the employee, since it was not subject to a substantial risk of forfeiture. A separation from employment is only an involuntary separation from employment if it is due to the independent exercise of the employer's unilateral authority to terminate the employee's services, other than due to the employee's implicit or explicit request if the employee was willing and able to continue performing services.[89] It may include an employer's failure to renew a contract at expiration if the employee was willing and able to enter into a new contract.[90] An employee's voluntary separation from employment for good reason (and defined in Prop. Reg. §1.457-11(d)(2)(ii)) is treated as an involuntary separation from employment.[91]

WHAT IS AN EXCESS PARACHUTE PAYMENT?

An excess parachute payment starts with a parachute payment. A parachute payment is a payment to an individual that is contingent on the employee's involuntary separation from employment (with some exceptions)[92] with the employer and also includes the present value of payments in the nature of compensation to (or for the benefit of) such individual that are contingent on such a separation. A parachute payment is an ''excess parachute payment'' to the extent it exceeds the base amount.[93] Both all *current* payments contingent on an involuntary separation from employment and the present value of all *future* payments contingent on an involuntary separation from employment are added together with the sum tested against three times the ''base amount.'' The three times the base amount is tested against the sum of the present value of future payments contingent upon the separation from employment plus the amounts paid currently for the same contingency.[94] If the sum of such contingent payments exceeds three times the base amount, there is a parachute payment, but the tax is applied to the excess of such sum of the contingent payments over the base amount (without multiplying the base amount times three).[95] It is important to note that the Final Regulations clarify that a covered employee's base amount is calculated including remuneration from the ATEO and all related organizations but that covered employee's parachute payment calculation includes all payments by the ATEO and all related organizations but are contingent on employee's involuntary separation from employment. However, only the ATEO is subject to the excise tax on excess parachute payments such ATEO makes to a covered

[86] Notice 2019-9, Q&A 23; Reg. §53.4960-3(e)(3).

[87] Notice 2019-9, Q&A 23; Reg. §53.4960-3(e)(3).

[88] Reg. §53.4960-3(a)(1).

[89] Notice 2019-9, Q&A 22; Reg. §53.4960-3(e), Reg. §53.4960-3(f).

[90] Notice 2019-9, Q&A 22; Treas. Reg. §53.4960-3(e), Reg. §53.4960-3(f).

[91] Notice 2019-9, Q&A 22; Reg. §53.4960-3(e), Reg. §53.4960-3(f).

[92] Notice 2019-9, Q&A 16 & 17; Reg. §53.4960-3(d) noting a payment is contingent on a separation from employment if the facts and circumstances that created the payment would not have been made in the absence of the employee's involuntary separation from employment.

[93] §4960(c)(5)(B)(i)-(ii); Notice 2019-9; Reg. 1.280G-1, Q&A 16; Reg. §53.4960-3(e).

[94] Notice 2019-9, Q&A 20(a); Reg. §53.4960-3(a)(1).

[95] Notice 2019-9, Q&A 25; Reg. §53.4960-3(a)(1).

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employee consistent with how the proposed regulations treated such amounts.[96] The limitation that excess parachute payments do not include amounts paid by related organization only applies if the amounts paid by the related organization was not paid for or on behalf of the ATEO.[97] A payment can be on an involuntary termination even if there is a release or noncompete or similar requirements.[98]

The general definition of a ''parachute payment''[99] does not include any payment that is a payment from a qualified retirement plan [100]that is triggered by a change in control under §280G(b)(6), and does not include any payment made under an annuity that is a tax-sheltered annuity under §403(b) or a qualified deferred compensation plan under §457(b).[101] A parachute payment also does not include any payments made to a licensed medical professional or a veterinarian, to the extent the payment is for the performance of medical or veterinary services by such professional.[102]

The parachute payment does not include any payment to an individual who is not at least a highly compensated employee under §414(q) (on the basis of the applicable plan year)[103] , which means employees who did not earn at least $130,000 (2020 or 2021) in the prior year are not part of the High Five subject to this tax.[104] Highly compensated employees are determined using the same determination as used for the qualified retirement plan.[105] However, an individual could be non-highly compensated in the prior year if they worked a short year and then be subject to the limitation in the next year, if the status of an individual as a non-highly compensated employee is determined using a prior year method and not the current year method.

A payment is in the nature of compensation (no matter the form of payment), if it arises out of the employment relationship, including refraining from performing services (noncompete).[106] It includes wages, salary, bonus, fringe benefits, life insurance, deferred compensation, vesting of equity rights, or property transfers.[107] The amount is reduced by any amount paid by the covered employee or the fair market value of any property that the covered employee transfers.[108] A transfer of property made and included in the taxable year the property is is made is included in income without considering the §83(b) election.[109] An option is included when it becomes vested.[110]

If a payment is accelerated or the substantial risk of forfeiture lapses (or the amount becomes vested) due to involuntary separation, then the value due to the acceleration or vesting due to involuntary separation is a value included as a payment triggered by the involuntary separation and part of the potential parachute payment.[111]

If the value of the payment without the acceleration is not reasonably ascertainable, and the acceleration of the payment does not significantly increase the present value of such payment without the acceleration, then the present value of the payment absent the acceleration is the amount of the accelerated payment and the value of the acceleration included as a parachute payment contingent on separation from employment is zero.[112] However if the present value of the payment without the acceleration is not reasonably ascertainable, but the acceleration significantly increases the present value of the payment, the future value of the payment contingent on a separation from employment is treated as equal to the amount of the accelerated payment.[113] If the acceleration is less than or equal to 90 days, the acceleration is not treated as significantly increasing the present value of the payment.[114]

If the involuntary separation from service causes a payment to vest and before such separation the payment was only contingent on the individual continuing to perform services and it was at least partially attributable to service before the payment date, then a special valuation rule applies. There are a number of valuation rules in Notice 2019-9 and in the Final Regulations. If an employee with an employment contract involuntarily terminates before the end of the contract term, the payment of damages is treated as

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[96] Fed. Reg. 6196, 6213 (Jan. 19, 2021) (referring to 85 Fed. Reg. 35,746, 35,763 (June 11, 2020).

[97] Reg. §53.4960-4(d)(1).

[98] Reg. §53.4960-3(d)(1).

[99] §4960(c)(5)(C); Notice 2019-9, Q&A 17; Reg. §53.4960-3(a)(2).

[100] Reg. §53.4960-3(a)(2)(i).

[101] §4960(c)(5)(C); Notice 2019-9, Q&A 17(b); Reg. §53.4960-3(a)(2).

[102] §4960(c)(5)(C)(iii); Notice 2019-9, Q&A 17(b)(3); Reg. §53.4960-3(a)(2)(iii).

[103] §414(q); Reg. §1.414(q)-1T, Q&A-14(a)(2).

[104] Notice 2019-9, Q&A 17(b)(4); Reg. §53.4960-3(a)(2)(iv)-§53.4960-3(a)(2)(v).

[105] Notice 2019-9, Q&A 17(b)(4); Reg. §53.4960-3(a)(2)(iv)-§53.4960-3(a)(2)(v).

[106] Reg. §53.4960-3(b).

[107] Reg. §53.4960-3(b).

[108] Reg. §53.4960-3(b)(2).

[109] Reg. §53.4960-3(c)(2).

[110] Reg. §53.4960-3(c)(3).

[111] Notice 2019-9, Q&A 24; Reg. §53.4960-3(f).

[112] Notice 2019-9, Q&A 24(b); Reg. §53.4960-3(f).

[113] Reg. §53.4960-3(f)(3).

[114] Reg. §53.4960-3(f)(3).

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payment contingent on an involuntary termination.[115] Payment for a covenant not to compete is also a payment for an involuntary separation.[116] Payments of amounts previously included as income are not parachute payments.[117] A payment under a window program is a payment contingent on an involuntary separation.[118] An involuntary separation is a separation from employment due to the independent exercise of the employer's unilateral authority to terminate the employee's services other than due to the employee's request implicitly or explicitly.[119]

Separation for ''Good Reason'' can be an involuntary separation if the facts and circumstances demonstrate it results from the employer's unilateral action that caused a material negative change in the relationship, such as a material reduction in duties, a negative change in conditions or a material reduction in compensation.[120] A safe harbor exists where material negative changes result in employment termination within two years of the change in conditions.[121] Separation from employment causing a good reason termination means the termination must occur within two years of the change in conditions.[122] Separation from employment has the same meaning as a separation from service under §409A using the default level for reduction in service.[123]

If an individual is amongst the High Five for the taxable year, or in prior years after 2016, it is possible that he or she could be subject to the excise tax solely on an excess parachute payment because the tax can be assessed on excess parachute payments even if the covered individuals does not earn over $1,000,000 on an annual basis. This means the excise tax could apply to one of the High Five of any of the organizations subject to the new limitation if the present value of remuneration triggered by the High Five employee's involuntary departure exceeds three times the ''base amount.'' If so, it constitutes a parachute payment; and once a parachute payment then the present value of the contingent remuneration in excess of the base amount is subject to the tax.[124]

HOW IS THE BASE AMOUNT USED TO CALCULATE THE TAX ON AN EXCESS PARACHUTE PAYMENT CALCULATED?

The ''base amount'' is used to determine whether or not a parachute payment is an excess parachute payment and subject to the excise tax under §4960. The excess parachute payment is determined by calculating the sum of all of the compensation currently paid due to involuntary separation from employment from the total compensation and adding the present value of the amount paid in the future by virtue of the termination of employment (i.e., the aggregate present value of the payments contingent on the involuntary separation)[125] and if that total compensation exceeds three times the ''base amount,'' then the payments are parachute payments.[126] The present value is calculated as of the date of separation from employment, except if the payment occurred earlier it is as of the date of payment.[127] The discount rate is 120% of the applicable federal rate under §1274(d) and per the regulations thereunder, it is compounded semi-annually.[128] From the total compensation paid by the ATEO due to the involuntary separation from employment, the ATEO's allocated portion of the ''Base Amount'' is deducted and the amount remaining is the ''excess parachute payment.''[129] The tax is calculated on the excess parachute payment. The actual tax is calculated on amounts paid by the ATEO due to the termination of employment in total that are in excess of the base amount allocated to the ATEO (not three times the ''base amount''), but the calculation of the tax only happens if the total exit triggered payments exceed an amount which exceeds the amount equal to the product of the ''base amount'' multiplied by three. The ''base amount'' concept is defined by the statute as being ''similar'' to the concept in §280G(b)(3).[130]

The portion of the ''Base Amount'' allocated to any parachute payment is the amount that bears the same ratio to the Base Amount as the present value the parachute payment bears to the aggregate present value of all parachute payments made or to be made to (or for the benefit of) the same covered employee. For example, if two related ATEO's each paid a parachute of $1 million to the same individual and Entity A had paid a $200,000 Base Amount and Entity B had paid the individual a $400,000 Base Amount for the two related organizations combined, the employee has

[115] Reg. §53.4960-3(d)(2).
[116] Reg. §53.4960-3(f)(3).
[117] Reg. §53.4960-3(d)(4).
[118] Reg. §53.4960-3(d)(5).
[119] Reg. §53.4960-3(e)(1).
[120] Reg. §53.4960-3(e)(2)(ii).
[121] Reg. §53.4960-3(e)(2)(iii).
[122] Reg. §53.4960-3(e)(2)(iii).
[123] Reg. §1.409A-1(h), Reg. §53.4960-3(e)(3).
[124] Reg. §53.4960(a).
[125] Reg. §53.4960-3(g).
[126] Reg. §53.4960-3(g).
[127] Reg. §53.4960-3(h).
[128] Reg. §53.4960-3(i).
[129] Notice 2019-9, Q&A 32; Reg. §53.4960-3(g).
[130] §4960(c)(5)(D).

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a base amount of $600,000. The $2 million exit payment exceeds three times the employee's base amount by $200,000. The base amount is allocated between Entity A and Entity B based on the compensation each paid as exit pay or each paid one-half of the $600,000 base amount payment, so each entity was allocated one-half of the $600,000 base amount and so each had $700,000 of excess parachute payment ($1 million - $300,000).[131]

Prior to Notice 2019-9, ''base amount'' used the §280G definition. The ''base amount'' defined in §280G(b)(3) is the individual's annualized includable compensation for the base period. The base amount under §280G is determined as the individual's compensation from the company that was includible in income over the base period specified in §280G(d)(2), which is the five taxable years of the individual ending prior to the year in which the change in control occurs (separation of employment for §4960) (e.g., for a change in control occurring on January 1, 2019, the base period would consider earnings in 2014, 2015, 2016, 2017, and 2018). If the individual did not work for the company for the full five preceding tax years, then the base period is the period during which the employee worked for the company with any partial years annualized to a full year's compensation.[132] However, because the base amount for §4960 is only ''similar'' to the §280G calculation, it is not clear if all aspects of the §280G calculation will apply. The guidance on the two base amount definitions is below.

§280G Base Amount

The compensation that is to be included in base compensation for purposes of §280G is the amount of compensation that is includable in the gross income of such individual for taxable years in that base period. If there are amounts paid that are not includable in income, such as salary reductions to purchase benefits under a cafeteria plan, fringe benefits that are not includable income, bonuses that are deferred, or other similar amounts such as contributions to a §403(b) annuity plan or a §401(k) plan, those amounts would not be included in the base amount. If a payment was made on a regular frequency, it counts in the calculation of the annualized amount for the base period, but if the payment is a one-time or infrequent payment, such as a signing bonus or a relocation payment or moving expenses, those amounts have historically not been included in the base period compensation[133]. Fringe benefits that are excluded from income are not included in calculation of the base amount even if they are included in calculation of the parachute payment.[134] Please note, reimbursement of moving expenses are no longer excluded from an employee's income after December 31, 2017, and prior to January 1, 2025, under 2017 Tax Act §11048). In the event an individual was hired during the same year in which he or she separated from service and was still among the five highest paid individuals by the entity, then the base amount compensation would not include any amounts paid that were contingent on his or her separation from employment and you would annualize amounts paid from date of hire through the date of separation from employment.[135]

Once the base compensation on an annualized basis is determined for §280G purposes for each of the five preceding years under §280G, next the sum of the base amounts for each of those five years is divided by five to obtain the ''base amount.'' If there are fewer than five full years available, the sum of the full years plus the annualized part years is calculated and that sum is divided by the sum of the number of full years plus the number of annualized partial year(s) to obtain that individual's base amount (e.g., the individual worked for 3½ years earning $50,000 per year in each of the three full years and $20,000 in the half year, for a total of $190,000 of four years of annualized compensation (50,000+50,000+50,000+(2 x 20,000)), which is divided by four for a base amount of $47,500). The base amount is then multiplied by three and if the sum of the payments contingent on the involuntary separation exceed such number, then there is a parachute payment and the excess parachute payment must be calculated. The base amount is deducted from the sum of the payments contingent on the involuntary separation and the excess is the excess parachute payment. Once an entity knows it has an excess parachute payment, then the compensation triggered by the involuntary separation from employment is reduced by the base amount with such excess then being subject to the excise tax.

However, in some circumstances the base amount under §280G may also pull in a portion of the compensation triggered by the change in control. The IRS ruled that severance paid under an employment agreement and amounts paid upon retirement under a salary continuation agreement that were accelerated into the year prior to the year in which the change in control occurred for an executive were included in the executive's base amount.[136]

The §280G principles are quick summaries of the calculation of the base amount under §280G and the

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[131] Notice 2019-9, Q&A 32, *Ex.* 1; see also Reg. §53.4960-3(l) for additional examples.

[132] Reg. §1.280G-1, Q&A-34(b), Q&A-35(a).

[133] Reg. §1.280G-1, Q&A 34(b), Reg. §1.280G-1, Q & A – 35(a); Reg. §53.4960-3(k).

[134] Reg. §53.4960-3(k)(3).

[135] Reg. §1.280G-1, Q&A 35(a).

[136] PLR 200430019.

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excess parachute payment under §4960. Under the initial guidance, only the principles in the §280G regulations that are referenced in Notice 2019-9 are relevant because there are concepts under §280G that do not exist under §4960 and thus those would not apply with respect to determining base amounts under §4960.[137] The preamble to Notice 2019-9 indicates that the guidance for §4960 decidedly took a different position than the position taken in the §280G regulations in Reg. §1. 280G-1 Q&A 9, 16, 22, 25, and 26[138] so it is important to watch the source of the guidance one might want to borrow from §280G.

§4960 Base Amount

The ''Base Amount'' is for purposes of §4960 is further defined in Notice 2019-9, Q&A 29-30 and in the Final Regulations[139] It is the average annual compensation for services performed as an employee of an ATEO or a related organization with respect to which the separation from employment occurred.[140] The ''Base Amount'' is measured after the ''Base Period'' which is the five most recent tax years ending before the date on which the separation from employment occurs. If an employee of an ATEO was not an employee for the full five years, then the individual's base period is the portion of the five year period that he or she was employed.[141] If the employee's Base Period is less than a full five year period because the employee was not employed for the full five year period, then for any short year, the individual's pay for the short period must be annualized.[142] The base amount only includes compensation that is includible in gross income for tax purposes, so excludable health benefits are not included in the Base Amount.[143] The Base Amount includes the income the employee earns from the ATEO or a related organization that was includible in the employee's gross income for tax purposes for the period in the year before the employee has a separation from employment and was not contingent on the separation from employment.[144]

CALCULATION OF TOTAL PARACHUTE PAYMENT

The parachute payment includes the amount paid in the current taxable year contingent upon one of the High Five's separation from employment and the present value of future payments one of the High Five receives as a payment contingent upon separation from employment.[145] If there are property transfers in conjunction with the separation from service from the company, then the rules under §280G(d)(3) and §280G(d)(4) will apply and transfers of property are to be valued at their fair market value. If the property is to be transferred in a future tax year, we assume guidance will indicate whether the statutory provision in §280G(d)(3) and §280G(d)(4) will be part of the similar concepts applicable to §4960. The present value of a payment is determined as of the date of separation from employment or, if the payment is made prior to that date, then to the date on which the payment is made.[146] The present value of future payments under §280G has been determined using a discount rate equal to 120% of the applicable federal rate in effect on the date as of which the present value is determined and such rate is under §1274(d) compounded semiannually.[147] The present value must be used if the right to receive an amount is a right to receive the amount in a year or years after the year in which the separation from the employment occurred.[148] The period is measured using the period until the payment is expected to be made.[149] However, the rate is the rate in effect on the date the contract was entered into, if such election to use such rate is provided, and both parties agreed and provided for such rate in the contract.[150]

If a payment is subject to one or more contingencies beyond the separation from employment, such as completing another condition that is uncertain, then when calculating the amount to be included to see if there is a parachute under the three times the base amount test and for allocation of the base amount, the employer must reasonably estimate what the likelihood is it will make the payment. If it is a 50% or more likelihood the payment will be made, then the full amount of the payment is included, but if the likelihood of payment is less than 50%, then the payment is excluded from both.[151] If the estimate of the likelihood of the contingency is later determined to be wrong, then the three times the base amount test and reallocation of the base amount must be recalcu-

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[137] Notice 2019-9; *See also* Reg. §53.4960-3(k), Reg. §53.4960-3(l).

[138] Notice 2019-9; *see also* Reg. §53.4960-3(k), Reg. §53.4960-3(l) .

[139] Reg. §53.4960-3(h)- Reg. §53.4960-3(l).

[140] Notice 2019-9, Q&A 29(a); Reg. §53.4960-3(h), Reg. §53.4960-3(k).

[141] Notice 2019-9, Q&A 30; Reg. §53.4960-3(l).

[142] Notice 2019-9, Q&A 29(b); Reg. §53.4960-3(k)(2).

[143] Notice 2019-9, Q&A 29(c); Reg. §53.4960-3(k)(3).

[144] Notice 2019-9, Q&A 31; Reg. §53.4960-3(k).

[145] §4960(c)(5)(B); Reg. §53.4960-3.

[146] Notice 2019-9, Q&A 26; Reg. §53.4960-3(h).

[147] §4960(c)(5)(E) and §280G(d)(3)-§280G(d)(4); Notice 2019-9, Q&A 27; Reg. §53.4960-3(i).

[148] Notice 2019-9, Q&A 26(b); Reg. §53.4960-3(j).

[149] Notice 2019-9, Q&A 27; Reg. §53.4960-3(i).

[150] Notice 2019-9, Q&A 27; Reg. §53.4960-3(i).

[151] Notice 2019-9, Q&A 28; Reg. §53.4960-3(j).

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lated.[152] The examples in the Reg. §1.280G–1, Q&A 33(d) are to be applied by analogy.[153] The present value must be used if the right to receive an amount is a right to receive the amount in a year or years after the year in which the separation from employment occurred.[154]

The payments in ''the nature of compensation'' counted toward the parachute payment include wages, bonuses, severance pay, fringe benefits, life insurance, pension benefits, and other deferred compensation (including amounts characterized as interest or earnings) and it includes the right to receive cash, accelerated vesting or a transfer of property.[155] Such payments are considered to be made in the taxable year in which the covered employee includes them in compensation.[156] Transfers of property are includible in the taxable year in which the property is transferred or would be includible in his income, disregarding any election he made under §83(b).[157] An option is transferred when it vests.[158]

The compensation treated as triggered by the involuntary separation from employment does not include a payment that would have been made because the substantial risk of forfeiture had ceased applying and the vesting of the individual's right to the payment would have occurred if the employee had remained employed for a subsequent period of time, but that was accelerated by the separation from employment is not treated as a payment that would have been made in the absence of an involuntary separation from employment,[159] and this means it is contingent on separation from employment and counted as part of the parachute payment.[160] A payment is that is substantially certain to be made at separation from employment is a payment that would be made whether or not the separation occurred. Requiring the employee to sign a release of claims, noncompetition or nondisclosure does not change the payment as contingent on separation.[161] Payment under an employment agreement for an involuntary separation before the end of the contract term as damages for breach of contract are treated as contingent on separation from employment.[162]

A payment for an individual not to compete or to refrain from providing services is a payment contingent on separation from employment if it would not have been paid except upon an involuntary separation from employment.[163] Any payment of an amount previously included in the individual's income is not contingent on separation from employment and would not be included as a parachute payment.[164] Payments under window programs are included as contingent on separation from employment.[165] If the above rules are used to vest or pay an amount that would not have occurred but for the involuntary separation, it is a payment contingent or separation from employment.[166]

If a payment is accelerated or a substantial risk of forfeiture lapses as the result of an involuntary separation from service, only the value due to the acceleration is treated as contingent on a separation from employment.[167] However accelerating a payment by 90 days or less is not treated as significantly increasing the present value of the payment.[168]

If an individual was a High Five in a prior year and receives payments after separation from employment, his compensation may still be subject to the §4960 excise tax in such later years if it exceeds the $1 million annual limit because compensation paid following separation from employment may not have been triggered by separation from employment (e.g., long term incentive awards maturing over time when performance goals are met), or even if it was triggered by separation from employment in an earlier tax year, the amounts subject to the excise tax for exceeding the $1 million annual limit do not include amounts which are ''excess parachute payments.''[169]

The Final Regulations clarified that only a parachute payment paid by an ATEO was subject to the excise tax on the excess parachute payment, this corrected the provision in Notice 2019-9 Q&A 1 which indicated the ATEO or a related organization may be liable for the tax on excess parachute payment.[170]

TAX CALCULATION

The tax is calculated on two pieces. First, remuneration subject to §4960 in excess of the $1 million limit (other than excess parachute payments)[171] paid to a covered employee who was involuntarily termi-

[152] Notice 2019-9, Q&A 28(b); Reg. §53.4960-3(j)(2).
[153] Notice 2019-9, Q&A 28(d); Reg. §53.4960-3(j).
[154] Notice 2019-9, Q&A 26(b); Reg. §53.4960-3(h)(1).
[155] Notice 2019-9, Q&A 18; Reg. §53.4960-3(b).
[156] Notice 2019-9, Q&A 19; Reg. §53.4960-3.
[157] Notice 2019-9, Q&A 19(b); Reg. §53.4960-3(c)(2).
[158] Notice 2019-9, Q&A 19(c); Reg. §53.4960-3(c)(3).
[159] Notice 2019-9; Reg. §53.4960-3(d).
[160] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[161] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[162] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[163] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[164] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[165] Notice 2019-9, Q&A 20 and 21; Reg. §53.4960-3(d).
[166] Notice 2019-9, Q&A 20(e); Reg. §53.4960-3(d).
[167] Notice 2019-9, Q&A 24; Reg. §53.4960-3(d).
[168] Notice 2019-9, Q&A 24; Reg. §53.4960-3(b).
[169] §4960(a)(1), §4960(c)(5); Reg. §53.4960-4.
[170] 86 Fed. Reg. 6196, 6213 (Jan. 19, 2021).
[171] Reg. §53-§4960(a)(1).

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nated in the applicable year[172] is calculated, and next the amount of any excess parachute payment paid by the organization to the covered employee[173] is calculated for covered employees who receive remuneration from an ATEO and if paid by or on behalf of an ATEO, by other related organization for allocation of annual remuneration subject to the tax. However, for excess parachute payments, the excise tax only applies to the ATEO.[174] The Final Regulations provide a mechanism for allocating the excise tax on excess annual remuneration amongst the ATEO(s) and related organizations. The amounts allocated to an ATEO or related organization are then added together, and the resulting sum is the amount subject to the excise tax of 21% (as long as the corporate income tax rates do not change). This means it could apply to an individual who is a High Five with respect to one of the organizations subject to §4960 who does not make $1 million in the current year, but received payments triggered by his or her separation from employment, if such payments in total exceed three times the ''base amount.'' This result could surprise many tax exempt and governmental organizations. Special rules exist for allocation liability for the excess remuneration tax if the individual is paid by the ATEO and one or more related organizations.[175]

WHAT TAXABLE YEAR IS USED TO CALCULATE THE TAX?

The excess remuneration paid and any excess parachute payments made or paid in the applicable year/calendar year ending with or within the taxable year of an ATEO or within the taxable year of a related organization is the applicable year. Such amount paid in the applicable year is treated as paid for the fiscal year of the ATEO in which the covered employee's taxable year ends.[176] For example, if a tax exempt hospital system paid its CEO $2 million in the calendar year 2018 and the hospital system's taxable year ran from July 1, 2018, to June 20, 2019, the excise tax on the excess remuneration paid during calendar year 2018 would be paid to the covered employee and trigger the excise tax for the hospital system for its tax year ending June 30, 2019.

LIABILITY FOR TAX

If the pay comes from more than one entity, then the tax that is imposed under the new §4960 is to be allocated amongst the employers who participate in paying such covered employee in proportion to how their respective compensation compares to the total amount of compensation paid by all employers of such employee.[177] So for instance, if one employer paid $500,000 of the $1.2 million of annual remuneration for a member of the High Five, such employee's allocation would be 5/12ths of the $200,000 of excess compensation, or $83,333.33 of compensation. However if an employer is liable for the tax as both an ATEO and a related organization with respect to the same employee, the employer is not liable for the tax in both capacities, but it is liable for the greater of the excise tax it would owe as an ATEO or the excise tax it would owe as a related organization with respect to the covered employee.[178]

REPORTING THE TAX

The taxes owed under §4960 are reported and paid on IRS Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*. If remuneration from a related organization is combined with the ATEO's remuneration of the High Five individual and used to calculate the tax, each ATEO and each related organization which paid remuneration to the individual must file a separate Form 4720 to report its share of the liability. [179] If an ATEO or its related organization are not liable for a §4960 excise tax for the taxable year, they need not file a Form 4720 for such taxable year, unless filing is otherwise required.[180]

PAYING THE TAX

The §4960 excise tax is due and must be paid and reported on Form 4720 by the 15th day of the fifth month after the end of the employer's taxable year. An automatic extension of the tax return filing due date may be requested by filing a properly completed and timely filed Form 8868, *Application for Extension of Time To File an Exempt Organization Return*; however, the extension of the deadline to file the return does **not** extend the time to pay the tax. The employer must pay the tax due by the original due date for the return to avoid assessment of interest and penalties.[181] Prepayment of the tax is permitted in specific circum-

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[172] Reg. §53.4960-1(c), Reg. §53.4960-4.

[173] Reg. §53.4960(a)(1)-§53.4960(2), Reg. §53.4960-4.

[174] 86 Fed. Reg. 6196, 6213 (Jan. 19, 2021); Reg. §53.4960-4(b).

[175] Notice 2019-9, Q&A 14; Reg. §53.4960-1, Reg. §53.4960-4.

[176] Notice 2019-9, Q&A 2; Reg. §53.4960-4.

[177] Notice 2019-9, Q&A 14; Reg. §53.4960-4.

[178] Notice 2019-9, Q&A 14(b); Reg. §53.4960-4(c).

[179] Notice 2019-9, Q&A 33; Reg. §53.4960-4.

[180] Notice 2019-9, Q&A 33; Reg. §53.4960-4.

[181] Notice 2019-9, Q&A 34; Reg. §53.4960-4.

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stances with specified rules for calculating the present value of the tax.[182]

No estimated tax payments are required of an ATEO or related organization with respect to the §4960 excise tax, only the annual filing and payment.[183] Payment of the tax is due on the 15th day of the month after the end of taxpayer's tax year on Form 4720,[184] subject to any extension. Quarterly payments of the excise tax are not required because §6655 was not amended to include the §4960 excise tax.[185]

EFFECTIVE DATE FOR NEW COMPENSATION RELATED EXCISE TAX

These new rules apply for taxable years of an employer beginning after December 31, 2017.[186] The excise tax provision does not include any transition rule for existing binding contracts for which there is no material modification as was contained in 2017 Tax Act §13601(e)(2) with respect to the changes to §162(m). Remuneration paid before the beginning of the employer's first taxable year that begins after December 31, 2017, is not subject to the §4960 excise tax.[187] This means every entity subject to §4960 needs to review executive and coaching staff contracts and compensation arrangements to determine the economic impact of this new excise tax to its budgets, recruitment efforts, and all existing contracts and to isolate and report amounts that may have been taxable to the individual on or before December 31, 2017.

This new excise tax must be considered as contracts are renewed and renegotiated and for anyone departing an entity subject to §4960 on or after January 1, 2018, or who is receiving parachute payments (payments triggered by separation from employment) on or after January 1, 2018, if it was paid in an employer's tax year that begins after December 31, 2017.[188] It is currently effective for taxable years after December 31, 2017, with no exception for payments made in 2018 related to prior year departures.

However, it also applies to persons who were a High Five after December 31, 2016, prior to the section's enactment and to High Five persons in predecessor entities and this may result in treating individuals who are no longer employed as subject to the tax if they are receiving pay after a voluntary separation or receiving deferred compensation that exceeds $1 million.[189] This would leave the former employee only subject to the $1 million limit, but this, as other effective date provisions, will hopefully be clarified in guidance or technical corrections.

While not designated as a transition rule or alteration of the effective date, the rules for determining ''remuneration'' include their own special rule that in effect provides a limited transition rule. If an individual was ''vested'' in remuneration that was not actually or constructively paid as of the close of the tax year preceding the first taxable year in which the employer is subject to §4960, such vested amounts are treated as if they were paid in the preceding taxable year and not subject to the excise tax.[190] So for example if the ATEO has a June 30 taxable year and its highest paid employee was fully vested in his long term incentive plan (LTIP) which was not actually or constructively paid on December 31, 2017, the vested LTIP[191] is treated as if it was paid on December 31, 2017, and so the LTIP is not treated as remuneration paid in the employer's tax year ending June 30, 2018. Thus, even if such amounts are not paid until December 31, 2019, they would not ever be subject to §4960's excise tax.

EFFECTIVE DATE OF FINAL REGULATIONS

The Final Regulations apply to taxable years beginning after December 31, 2021.[192] A taxpayer may rely on Notice 2019-9 until the Final Regulation's applicability date. Taxpayers may rely on Notice 2019-9 in its entirety, the proposed regulations in their entirety, or to the Final Regulations for taxable years beginning after December 31, 2017, and before December 31, 2021 or a reasonable good faith interpretation of the statute.[193]

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[182] Notice 2019-9, Q&A 34; Reg. §53.4960-4.

[183] Notice 2019-9, Q&A 35; Reg. §53.4960-4.

[184] 86 Fed. Reg. 6196, 6213 (Jan 19, 2021).

[185] 86 Fed. Reg. 6196, 6213 (Jan 19, 2021).

[186] Notice 2019-9, Q&A 39; Reg. §53.4960-6.

[187] Notice 2019-9, Q&A 39; Reg. §53.4960-6.

[188] Notice 2019-9, Q&A 39(a); Reg. §53.4960-6.

[189] See §4960(a)(1) regarding the tax on excess remuneration not applying to amounts paid as parachute payments so that a parachute payment is not taxed due to exceeding the $1,000,000 and as a parachute payment.

[190] Notice 2019-9, Q&A 13(b)(2)(D)(iii); Reg. §53.4960-2(b)(3), Reg. §53.4960-3(d)(4)

[191] For purposes of this article an LTIP is a long term incentive payment whose payment is triggered based on the individual's and corporation's performance in a given time period and paid at a specified date several years later for each performance period, provided the individual either remains employed or remains employed to a certain age and does not violate a non-compete provision in the LTIP until the payment date.

[192] 86 Fed. Reg. 6196, 6214 (Jan. 19, 2021).

[193] 86 Fed. Reg. 6196, 6214 (Jan. 19, 2021).

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SPECIAL RULE FOR ENTITIES WITH PUBLICLY TRADED SECURITIES AND A CHARITABLE FOUNDATION

Companies with publicly traded securities that are subject to §162(m) should still consider the implications of §4960 if the company's officers subject to $1 million limit in §162(m) are also employed by a charitable foundation that is a ''related organization.'' In a provision apparently intended to avoid penalizing the same compensation paid by different related organizations to the same individual, §4960(c)(6) states that compensation for which a deduction is not allowed under §162(m) shall not be taken into account for purposes of §4960.[194] Section 162(m) applies only to compensation paid to certain executives and highly paid individuals of entities with publicly traded securities, and it results in nondeductible compensation. Such nondeductible compensation could be aggregated with the compensation paid by a foundation which constitutes a ''related organization.'' However, but for new §4960(c)(6), the nondeductible compensation under §162(m) could also be subject to §4960's excise tax if the same individual is subject to §162(m) and also a High Five individual with respect to the foundation. How this subsection applies to such companies and their affiliated foundations will need to be explained in guidance. The simplest way to avoid this is to not employ any individuals who are subject to §162(m) in an affiliated/related tax-exempt organization as the I.R.C.appears to operate to preclude using the $1 million limit twice.

GENERAL PRACTICAL STEPS TO ANALYZE FOR EXCESS ANNUAL REMUNERATION

The following steps propose on way to approach determining the excess annual remuneration under §4960:

(1) Determine if the entity is an ATEO.

(2) Determine all of the ''related organizations'' to the ATEO.

(3) Determine if the ATEO and any of the related organizations employ, as common law employees, any of the same individuals.

(4) Calculate the ''remuneration'' the ATEO and each of the related organizations pay to the most highly paid common law employees and all covered employees from prior years since December 31, 2016, and any common law employees and then the remuneration each pays to commonly employed covered employees and to the group of individuals who have ever have been in the High Five since December 31, 2016, including at predecessor entities (after determining which entities are predecessors under the Final Regulations as opposed to those under good faith compliance with applicable years after December 31, 2021),[195] and those who are the most likely suspects to be within the High Five. The total tax liability with respect to each covered employee is 21% of total remuneration paid to a covered employee in excess of $1 million.

(5) Determine if any of such individuals are providing medical or veterinary services as part of their services and review their employment contracts to determine if such agreements allocate pay between medical or veterinary services and other pay. Determine if there is another reasonable basis to make such division. Document the amounts supported as excludible from each individual's pay for medical or veterinary services, if applicable, and deduct that from total pay to calculate remuneration subject to §4960.

(6) For each potential High Five, aggregate remuneration subject to §4960 for the ATEO and related organizations for the calendar year ending with or within the ATEO's taxable year.

(7) Identify the High Five for the current applicable year from the remuneration list for the current year for the ATEO and add them to the list of prior High Fives.

(8) Calculate excess remuneration subject to §4960 over $1 million for the current applicable year for each individual. Verify that you are not including amounts whose payment were triggered by an involuntary separation form service and which are subject to tax as an excess parachute payment.

(9) Allocate the excess remuneration amount the ATEO and related organizations paid with respect to each individual who is part of the High Five group.

(10) Each ATEO and related organization files the Form 4720 with its allocation excess remuneration for the High Five for the year.

Some potential steps to calculate the excise tax on parachute payments as a starting point for a simple situation without a discussion of the allocation of the tax amongst entities.

(1) Take the High Five group determined in items (1) through (7) above.

[194] §4960(c)(6).

[195] Reg. §53.4960-6(a).

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(2) For each High Five individual who involuntarily separated from the ATEO during the year now calculate whether there is an excess parachute payment with respect to any of such individuals. (One option is to use the steps outlined in the preamble to Notice 2019-9.

(3) Determine if any of the covered employees identified above was entitled to receive remuneration because such individual was involuntarily separated from employment.

(4) Calculate the total present value of the aggregate payments that were triggered on the separation from employment.

(5) Calculate the ''base amount'' for each covered employee who was involuntarily separated.

(6) Determine if the sum of the present value of the amounts paid to the covered employee due to the involuntary separation from employment exceed three times the ''base amount.''.

(7) If the present value of the amounts paid to the covered employee due to an involuntary separation exceeded three times the individual's ''base amount'' then to the extent the present value of the contingent payments exceeds the ''base amount'' (not multiplied by three), the excess is the excess parachute payment which is subject to the excise tax.

(8) Each ATEO which paid a portion of the excess parachute payment must calculate its tax based on its allocated share of the tax, using the allocated share of the base amount.[196]

COMPENSATION COMMITTEE CONSIDERATIONS

There are several immediate considerations for compensation committees regarding the potential impacts of the new excise tax under the 2017 Tax Act. Initially, it will be important to identify the High Five based on 2017 compensation then to project the High Five in 2018 whose compensation is potentially subject to the new tax. As part of this process, it will be important to apply compensation exclusions such as compensation paid to physicians for medical services rendered. The compensation committee will then be able to assess the financial impact of the excise tax. Ultimately the compensation committee will need to balance the need to provide market competitive compensation to attract top executive talent against the reality of paying the excise tax on compensation in excess of $1 million. Obviously capping executive pay at $1 million could result in a talent exodus whereas the addition of the excise tax increases the cost of doing business. In considering various types of compensation packages, the compensation committee will also need to be mindful of the ''private benefit'' and ''private inurement'' tax doctrines which limit a tax-exempt organization's actions in structuring executive compensation.

Set forth below are several additional considerations that compensation committees will need to address with regard to their executive compensation programs:

- Determine whether restructuring is an option to consolidate payrolls and limit the number of entities potentially subject to the excise tax.
- Analyze whether the use of deferred compensation will either shelter income from the excise tax, delay taxation, or at least reduce the impact to a one-time tax event, considering the potential implications of §457(f) and §409A.
- Analyze whether deferred compensation can be structured to pay on passage of time rather than being triggered by separation from employment.
- Identify future departures from the High Five that are still receiving payments triggered by their separation from service and identify if any of such compensation was paid based upon a different trigger.
- Consider whether the use of loans and insurance policies (e.g., split dollar) such as described by ESPN in the article on the compensation package for Coach Jim Harbaugh at the University of Michigan might provide a different compensation strategy to provide for the individual's family.[197]
- Consider using long term incentives where payment is triggered only by employment for a

[196] Reg. §53.4960-4(d).

[197] *Michigan, Jim Harbaugh agree to increase compensation in form of life insurance loan*, http://www.espn.com/college-football/story/_/id/17332547/michigan-wolverines-jim-harbaugh-agree-increased- compensation-form-life-insurance-loan; See also, T.D. 9092, 68 Fed. Reg. 54,336 (Sept. 17, 2003);Rev. Rul. 2003-105. Notice 2007-34, IRS Info Letter 2007-15, and Notice 2002-8 should be reviewed when considering a split-dollar arrangement for tax-exempt organizations as §457(f) generally requires an employee of a tax-exempt organization (other than certain church organizations under §3121(w)(3) or a state or local government) to include deferred compensation in gross income when it is not subject to a substantial risk of forfeiture. Split-dollar arrangements governed by the economic benefit regime are life insurance deferred compensation arrangements; thus, an employee of a tax-exempt organization or of a state or local government, may have to include an amount in gross income attributable to an equity split-dollar life insurance arrangement if not property structured

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specified period followed by payment on a specified date to preserve the substantial risk of forfeiture and avoid any assertion the payment occurred due to an involuntary termination of employment.

Structure new nonqualified deferred compensation to be paid either at a specified date unrelated to separation from employment. As a final matter, it will be imperative for compensation committees to be mindful of their continuing compliance obligations under the Intermediate Sanctions regulations[198] and their reporting obligations pursuant to IRS Form 990, *Return of Organization Exempt From Income Tax*, and the private inurement and private benefit restrictions. The fact that a compensation package may be justified under §4958 does not protect it from the excise tax under §4960.[199] Similarly, the payment of remuneration subject to the §4960 excise tax is not determinative as to whether the remuneration paid to the covered nonemployee is excessive or unreasonable compensation for purposes of §4958. Compensation paid to a covered employee that does not trigger a §4960 excise tax provides no presumption, inference or basis for concluding that compensation paid to an individual that does not trigger the §4960 tax is reasonable compensation for purposes of determining the excise tax under §4960. Similarly, compensation subject to the excise tax still must be reasonable under the Intermediate Sanctions regulations.[200] In addition structuring executive compensation for a tax exempt organization must consider other concepts and limits in the tax exempt organization world such as the prohibition on private inurement[201] and private benefit[202]. Some state laws governing tax exempt entities may regulate the use of the charitable entity's funds that must be considered in compensation decisions. Structuring compensation in the governmental entity arena must also consider state laws regarding compensation of public employees and use of public funds.

In the end, §4960 may have its greatest impact on the budgeting, accounting, and fundraising functions within tax exempt entities as tax exempt organizations still must pay the salaries demanded by the marketplace to recruit and retain top level executives and coaches.

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even if the employee does not have current access to the policy cash surrender value under the final regulations on split-dollar life insurance arrangements found at T.D. 9092.

[198] Reg. §53.4958-0.

[199] Notice 2019-9, Q&A 36.

[200] Notice 2019-9, Q&A 36.

[201] See *Easter House v. Commissioner*, 12 Cl. Ct. 476 (1987), *aff'd* 846 Fed. Cir. 1988); PLR 201740022, and PLR 201541012.

[202] *See Church of Scientology of Cal. v. Commissioner*, 823 F. 2d 1310 (9th Cir. 1987), *cert. den'd* 484 U.S. 9 (1987); PLR 201330043.

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