

Current Federal Tax Developments

Week of January 7, 2019

Edward K. Zollars, CPA
(Licensed in Arizona)

ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
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Section: 4960

92 Page Notice Issued By IRS to Explain Tax on Excess Compensation for Employees of Tax-Exempt Organizations

Citation: Notice 2019-9, 12/31/18

The IRS has issued [Notice 2019-9](#), a 92-page document that gives, in a question and answer format, information on the application of the tax on excess compensation of certain employees of tax-exempt organizations under IRC §4960, added by the Tax Cuts and Jobs Act.

IRC §4960 provides for the following tax imposed on certain not for profit organizations:

IRC §4960 Tax on excess tax-exempt organization executive compensation

(a) Tax imposed. -- There is hereby imposed a tax equal to the product of the rate of tax under section 11 and the sum of --

(1) so much of the remuneration paid (other than any excess parachute payment) by an applicable tax-exempt organization for the taxable year with respect to employment of any covered employee in excess of \$1,000,000, plus

(2) any excess parachute payment paid by such an organization to any covered employee.

For purposes of the preceding sentence, remuneration shall be treated as paid when there is no substantial risk of forfeiture (within the meaning of section 457(f)(3)(B)) of the rights to such remuneration.

(b) Liability for tax. -- The employer shall be liable for the tax imposed under subsection (a).

(c) Definitions and special rules. -- For purposes of this section --

(1) Applicable tax-exempt organization. -- The term "applicable tax-exempt organization" means any organization which for the taxable year --

(A) is exempt from taxation under section 501(a),

(B) is a farmers' cooperative organization described in section 521(b)(1),

(C) has income excluded from taxation under section 115(1), or

(D) is a political organization described in section 527(e)(1).

(2) Covered employee. -- For purposes of this section, the term "covered employee" means any employee (including any former employee) of an applicable tax-exempt organization if the employee --

(A) is one of the 5 highest compensated employees of the organization for the taxable year, or

(B) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

(3) *Remuneration.* -- For purposes of this section:

(A) *In general.* -- The term "remuneration" means wages (as defined in section 3401(a)), except that such term shall not include any designated Roth contribution (as defined in section 402A(c)) and shall include amounts required to be included in gross income under section 457(f).

(B) *Exception for remuneration for medical services.* -- The term "remuneration" shall not include the portion of any remuneration paid to a licensed medical professional (including a veterinarian) which is for the performance of medical or veterinary services by such professional.

(4) *Remuneration from related organizations.* --

(A) *In general.* -- Remuneration of a covered employee by an applicable tax-exempt organization shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity.

(B) *Related organizations.* -- A person or governmental entity shall be treated as related to an applicable tax-exempt organization if such person or governmental entity --

(i) controls, or is controlled by, the organization,

(ii) is controlled by one or more persons which control the organization,

(iii) is a supported organization (as defined in section 509(f)(3)) during the taxable year with respect to the organization,

(iv) is a supporting organization described in section 509(a)(3) during the taxable year with respect to the organization, or

(v) in the case of an organization which is a voluntary employees' beneficiary association described in section 501(c)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.

(C) *Liability for tax.* -- In any case in which remuneration from more than one employer is taken into account under this paragraph in determining the tax imposed by subsection (a), each such employer shall be liable for such tax in an amount which bears the same ratio to the total tax determined under subsection (a) with respect to such remuneration as --

(i) the amount of remuneration paid by such employer with respect to such employee, bears to

(ii) the amount of remuneration paid by all such employers to such employee.

(5) Excess parachute payment. -- For purposes of determining the tax imposed by subsection (a)(2) --

(A) In general. -- The term "excess parachute payment" means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

(B) Parachute payment. -- The term "parachute payment" means any payment in the nature of compensation to (or for the benefit of) a covered employee if --

(i) such payment is contingent on such employee's separation from employment with the employer, and

(ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such separation equals or exceeds an amount equal to 3 times the base amount.

(C) Exception. -- Such term does not include any payment --

(i) described in section 280G(b)(6) (relating to exemption for payments under qualified plans),

(ii) made under or to an annuity contract described in section 403(b) or a plan described in section 457(b),

(iii) to a licensed medical professional (including a veterinarian) to the extent that such payment is for the performance of medical or veterinary services by such professional, or

(iv) to an individual who is not a highly compensated employee as defined in section 414(q).

(D) Base amount. -- Rules similar to the rules of 280G(b)(3) shall apply for purposes of determining the base amount.

(E) Property transfers; present value. -- Rules similar to the rules of paragraphs (3) and (4) of section 280G(d) shall apply.

(6) Coordination with deduction limitation. -- Remuneration the deduction for which is not allowed by reason of section 162(m) shall not be taken into account for purposes of this section.

(d) Regulations. -- The Secretary shall prescribe such regulations as may be necessary to prevent avoidance of the tax under this section, including regulations to prevent avoidance of such tax through the performance of services other than as an employee or by providing compensation through a pass-through or other entity to avoid such tax.

Until the final regulations are issued by the IRS, Notice 2019-9 provides guidance in this area. Generally the organization is allowed to use a reasonable interpretation of the law applied consistently until the final regulations are issued—but the Notice provides certain interpretations that the IRS has defined as “not reasonable” which means organizations will

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need to review the Notice if for no other reason than to insure that the position they are taking is not a proscribed position (at least if the organization doesn't want to go to court).

The notice begins with a long preamble which attempts to explain generally the reasoning behind the provisions in the notice, followed by a series of 39 questions and answers dealing with these rules.

The list of questions for which the IRS provides some sort of answer in the notice is provided below:

A. Section 4960 — In General

Q-1: What is the effect of section 4960?

Q-2: What year is used in calculating the section 4960 excise tax?

Q-3: Who is liable for the section 4960 excise tax?

B. Applicable Tax-Exempt Organizations and Related Organizations

Q-4: What is an applicable tax-exempt organization within the meaning of section 4960(c)(1)?

Q-5: When is a governmental entity an applicable tax-exempt organization within the meaning of section 4960(c)(1)?

Q-6: May a governmental entity with a determination letter recognizing its tax exemption relinquish its section 501(c)(3) status?

Q-7: What is a related organization for purposes of section 4960?

Q-8: What is the meaning of "control" for purposes of section 4960(c)(4)(B)(i)-(ii) and Q/A-7 of this notice?

C. Covered Employees

Q-9: Who is a covered employee within the meaning of section 4960(c)(2)?

Q-10: How are the five highest-compensated employees determined?

D. Excess Remuneration

Q-11: What is excess remuneration paid by an applicable tax-exempt organization under section 4960(a)(1)?

Q-12: What is remuneration under section 4960(c)(3)?

Q-13: When is remuneration treated as paid for purposes of section 4960(a)(1)?

Q-14: How is liability for the section 4960(a)(1) excise tax determined if remuneration is paid to a covered employee by both an applicable tax-exempt organization and a related organization?

E. Medical and Veterinary Services

Q-15: How is remuneration for medical services treated under section 4960?

F. *Excess Parachute Payments*

- Q-16: What is an excess parachute payment under section 4960(c)(5)(A)?*
- Q-17: What is a parachute payment under section 4960(c)(5)(B)?*
- Q-18: What is a payment in the nature of compensation?*
- Q-19: When is a payment in the nature of compensation considered to be made?*
- Q-20: What is a payment that is contingent on an employee's separation from employment?*
- Q-21: What is a payment made under a window program?*
- Q-22: What is an involuntary separation from employment?*
- Q-23: What is a separation from employment?*
- Q-24: How is an accelerated payment or accelerated vesting resulting from an involuntary separation from employment treated?*

G. *Three-Times-Base-Amount Test for Parachute Payments*

- Q-25: Are all payments that are in the nature of compensation, made to a covered employee, and contingent on a separation from employment, parachute payments?*
- Q-26: As of what date is the present value of a payment determined?*
- Q-27: What discount rate is used to determine present value?*
- Q-28: If the present value of a payment to be made in the future is contingent on an uncertain future event or condition, how is the present value of the payment determined?*
- Q-29: What is the base amount for purposes of section 4960(c)(5)(D)?*
- Q-30: What is the base period?*
- Q-31: How is the base amount determined in the case of a covered employee who did not perform services for the applicable tax-exempt organization (or a predecessor entity or a related organization), prior to the calendar year in which the separation from employment with the applicable tax-exempt organization occurred?*

H. *Computation of Excess Parachute Payments*

- Q-32: How is the amount of an excess parachute payment computed?*

I. *Reporting Liability Under Section 4960*

- Q-33: How do applicable tax-exempt organizations or related organizations report and pay the excise tax imposed under section 4960?*
- Q-34: When is the excise tax imposed under section 4960 due?*
- Q-35: Are applicable tax-exempt organizations or related organizations required to pay estimated taxes for the excise tax imposed under section 4960?*

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J. Miscellaneous Issues

Q-36: Does the payment of remuneration subject to excise tax under section 4960 automatically constitute an excess benefit transaction under section 4958?

Q-37: Does the payment of remuneration subject to excise tax under section 4960 necessarily constitute an act of self-dealing described in section 4941?

Q-38: Does section 4960 apply to amounts to which section 162(m) applies?

K. Effective Date

Q-39: What is the effective date of section 4960?

The Notice provides the following information regarding the ability of taxpayers to rely upon this guidance:

The Treasury Department and the IRS intend to issue further guidance regarding section 4960 in the form of proposed regulations. Until further guidance is issued, taxpayers may rely on the rules in this notice for purposes of section 4960 effective from December 22, 2017 (the date of enactment). Further guidance will be prospective and will not apply to taxable years beginning before the issuance of such guidance.