

TYPES NOT MAPPED YET June 12, 2019 | TTR not mapped yet | Lori W. Jones

Section 4960 Excise Tax: What tax-exempt employers need to know

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The Tax Cuts and Jobs Act added Section 4960 to the Internal Revenue Code (Code).¹ It imposes an excise tax on applicable tax-exempt organizations (ATEO) equal to the Code Section 11 rate (currently 21%) of (i) remuneration in excess of \$1 million and (ii) excess parachute payments paid to covered employees. Section 4960 is designed to put ATEOs on equal tax footing with taxable organizations that are subject to the Code Section 162(m) \$1 million limit on deductible compensation and the excise tax on excess parachute payments under Code Section 280G. Section 4960 is effective for taxable years beginning after December 31, 2017.

On December 31, 2018, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2019-09² which provides interpretative guidance on Section 4960 pending the issuance of final regulations. In the absence of final regulations, taxpayers are required to comply with Section 4960 based on a good faith, reasonable interpretation. Notice 2019-09 provides that actions taken in accordance with Notice 2019-09 will be deemed a good faith, reasonable interpretation of the statute.

Notice 2019-09 includes 27 pages of guidance with respect to Section 4960. The following are key concepts tax-exempt employers should know about Section 4960 based on the statute, legislative history and guidance issued by the IRS in Notice 2019-09.

Not just for tax exempt organizations

The Section 4960 excise tax is generally imposed on ATEOs. An ATEO is defined as an organization that:

- Is exempt from tax under Code Section 501(a) (including Section 501(c) charitable organizations);
- Is a farmers' cooperative organization under Code Section 521(b)(1);
- Has income excluded from taxation under Code Section 115(1); or
- Is a political organization described in Code Section 527(e)(1).³

If remuneration is paid to a covered employee by both an ATEO and a person or governmental entity related to the ATEO,⁴ the excise tax is allocated based on the same ratio as the remuneration paid by each ATEO and related organization to the total remuneration paid to the covered employee by all the employers.⁵ The Treasury Department and the IRS interpret the term "related person or governmental entity" to include related taxable organizations and related governmental units or other governmental entities.⁶ Thus, the excise tax can be imposed on a taxable organization that is related to the ATEO. Such taxable organization would be required to file Form 4720 to report its portion of the Section 4960 excise tax liability.⁷

Written agreements between ATEOs and related organization as to the allocation of the excise tax are ignored in allocating the Section 4960 excise tax.⁸

Once a covered employee, always a covered employee

A covered employee is a common law employee who is among the five highest compensated employees of an ATEO for the current year or for any preceding taxable year beginning after December 31, 2017. As a result, an individual who qualifies as a covered employee for a taxable year after 2017 will always be characterized as a covered employee. There is no minimum amount of remuneration to qualify as a covered employee⁹ and the excise

tax can be imposed with respect to covered employees who would otherwise qualify as non-highly compensated employees for purposes of qualified retirement plan rules. In addition, if there is more than one ATEO in a group of tax-exempt organizations, the covered employees are determined with respect to each ATEO in the group. Accordingly, a group of ATEOs will have more than five covered employees.¹⁰

Remuneration paid means remuneration vested

The Section 4960 excise tax is imposed on remuneration paid to a covered employee during the taxable year. Remuneration paid to a covered employee is calculated based on the calendar year ending with or within the employer's tax year.¹¹

Code Section 4960 defines remuneration as Code Section 3401 wages, excluding Roth contributions and including amounts included in gross income under Code Section 457(f).¹² Remuneration is considered paid when it is no longer subject to a substantial risk of forfeiture, as defined in Code Section 457(f)(3)(B).¹³ Thus, remuneration is calculated in the year of vesting. This rule applies to all remuneration and is not limited to remuneration or nonqualified deferred compensation that is subject to Code Sections 457(f) or 409A.¹⁴ A present value calculation is used for remuneration that will actually be paid to an employee in a later year.

Exclusion for remuneration for medical and veterinary services

Remuneration paid to a licensed medical professional for the direct performance of medical or veterinary services is not subject to Section 4960.¹⁵ A licensed medical professional is an individual licensed under state or local law to perform medical services, including nursing services. The exclusion does not apply to remuneration paid for other types of services, such as administrative or management services.¹⁶ If necessary, an allocation between remuneration for medical services and administrative or management services must be made. If an employment agreement or similar contract identifies remuneration to be paid for various services, such allocation must be applied unless demonstrated to be unreasonable under the facts and circumstances. In the absence of a written agreement, an employer may use a reasonable allocation method, including a representative sample of records.

Excess parachute payments

Section 4960 imposes an excise tax on excess parachute payments. Unlike other remuneration, there is a minimum dollar limit on the amount of excess parachute payments. A parachute payment is a payment in the nature of compensation that (i) is contingent on an employee's separation from employment and (ii) exceeds three times the employee's base amount.¹⁷ The Section 4960 rules are similar, but not identical to, the excess parachute payment rules under Code Section 280G. One important difference is that Section 280G applies to payments contingent on a change in control while Section 4960 applies to payments contingent on an employee's separation from employment. Notice 2019-09 limits the term "separation from employment" to an involuntary separation from employment.¹⁸ However, the IRS notes that this standard may be expanded in future guidance if it determines that there are additional separation from employment conditions that result in vesting of payments.¹⁹

No grandfathering for amounts credited prior to effective date

Because Section 4960 imposes the excise tax when remuneration is vested, it has a retroactive impact on remuneration credited in taxable years prior to 2018 but not yet vested. Only amounts of remuneration actually paid or vested prior to January 1, 2018, will fall outside the Section 4960 excise tax. In addition, any earnings on or after January 1, 2018, with respect to previously vested remuneration will be subject to the excise tax.²⁰

No indexing

The \$1 million limit is not indexed for inflation. Depending on future inflation, this increases the likelihood that the excise tax will be imposed on covered employees.

Positions deemed not in good faith

Notice 2019-09 sets forth the following positions that, if taken by taxpayers, will be considered not a good faith, reasonable interpretation of Section 4960:

- Taxable organizations or governmental entities related to an ATEO are not liable for their share of the excise tax attributable to remuneration paid to a covered employee;²¹
- A covered employee ceases to be a covered employee after a period of time;²²
- Remuneration for medical services is taken into account for purposes of identifying the five highest compensated employees of an ATEO;²³ and
- A group of ATEOs has a single set of five highest compensated employees.²⁴

Conclusion

While the above summarizes some important concepts included in Notice 2019-09 with respect to the Section 4960 excise tax, the Notice also includes valuable details on the calculation of the excise tax as well as examples of its application. Tax-exempt employers should consult Notice 2019-09 and watch for future IRS guidance with respect to the excise tax.

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1. Public Law 115-97. [↔](#)
2. 2019-04 I.R.B. (January 22, 2019). [↔](#)
3. IRC §4960(c)(1). [↔](#)
4. A related organization is a person or governmental entity that (i) controls, or is controlled by, the ATEO, (ii) [↔](#)
5. Notice 2019-09, Q&A-14(a), p. 419. [↔](#)
6. Id. at Q&A-7, p. 414. [↔](#)
7. Id. at Q&A-33(a), p. 427. [↔](#)
8. Id. at Q&A-3(c), p. 414. [↔](#)
9. Id. at Q&A-9, p. 415. [↔](#)
10. Id. at p. 415. [↔](#)
11. Id. at Q&A-2, p. 413. [↔](#)
12. IRC §4960(c)(3)A. [↔](#)
13. IRC §4960(a). [↔](#)
14. Notice 2019-09 at Q&A-13(a), p. 416. [↔](#)
15. Id. at Q&A-15. p. 420. [↔](#)
16. Id. [↔](#)
17. IRC §4960(c)(5)(B). [↔](#)
18. Notice 2019-09, at Q&A-20(a), p. 422 [↔](#)
19. Notice 2019-09. at p. 411. [↔](#)
20. Id. at p. 413 and Q&A-13, p. 416. [↔](#)
21. Id. at p. 406. [↔](#)
22. Id. at p. 407. [↔](#)
23. Id. at p. 409. [↔](#)
24. Id. at p. 409. [↔](#)

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