THE IRS'S INTERIM GUIDANCE ON SECTION 4960 LEAVES CORPORATE PHILANTHROPISTS WONDERING ABOUT THE FEASIBILITY AND COST OF COMPLIANCE

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Section 4960, enacted as part of the 2017 Tax Cuts and Jobs Act, imposes a 21% excise tax on remuneration exceeding $1 million paid by an "applicable tax-exempt organization" (ATEO) or its related organizations to "covered employees." In addition, "excess parachute payments" to employees of an ATEO are also subject to the excise tax. Given the terse language of Section 4960, tax-exempt organizations and their corporate sponsors hoped that the IRS would clarify the application of Section 4960 before 2018 tax returns were due. Indeed, in early 2019, the IRS released Notice 2019-09[1] (the "Notice") in the form of questions and answers. However, the Notice did not provide needed guidance addressing whether and how the excise tax applies in the common situation where corporate executives of a for-profit company provide volunteer services to the corporate foundation. Moreover, the Notice seemingly broadened the reach of Section 4960 by treating officers of an ATEO as the ATEO's employees. While awaiting further guidance from the IRS, ATEOs and related for-profit corporations may take positions based on a good faith, reasonable, interpretation of the statute, but they would prefer to have the application of the excise tax rules to corporate foundations directly addressed in such guidance.

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This article summarizes the relevant provisions of the Notice, suggests possible interpretations of the statute and Notice with respect to corporate volunteers, and recommends clarifications for the IRS to implement in its subsequent guidance. This article also urges the affected community to continue being vocal about the issue to help move the guidance in a more sensible direction.

Summary of the Relevant Provisions of the Notice

Section 4960(a) provides that the excise tax applies to remuneration in excess of $1 million paid by an ATEO to a covered employee. The excise tax is imposed on the employer and is equal to the corporate tax rate (currently 21%). The excise tax applies not only to remuneration paid by the ATEO, but under Section 4960(c)(4), also to remuneration paid by a "related person" (or by a "related organization"). According to the Notice, the Treasury and the IRS interpret a related person to include "not only related ATEOs but also related taxable organizations and related governmental units or other governmental entities."[2] If an organization controls, or is controlled by, an ATEO or if an organization is controlled by the persons who control an ATEO, it is "related" to the ATEO within the meaning of the statute. The Notice defines "control" as the ownership of more than 50% of stock in a corporation, more than 50% of the profits or capital interests in a partner-

ship, as well as more than 50% of the beneficial interests in a trust.

Most critical to the scenario faced by corporate foundations, Q&A 8(a)(4) of the Notice defines "control" for nonstock organizations, which include nonprofit organizations. An ATEO will be deemed controlled by an entity if more than 50% of the ATEO's directors or trustees are the representatives of, or controlled by, that entity. An ATEO will control an entity if more than 50% of the directors and trustees of an entity are representatives of, or controlled by, the ATEO. The Notice defines a representative to include a trustee, director, agent, or employee. The Notice indicates that "control" includes the power to remove and designate a new trustee or director. Thus, for example, if a majority of the board of directors of a corporate foundation is comprised of the employees of its corporate founder, then the foundation would appear to be deemed controlled by the employees of the corporate founder, and thus indirectly controlled by the corporate founder, so that the corporate founder is a related organization under Section 4960. Similarly, a corporation would be a related organization if it can make appointments to the board of directors of the charity (which is typically the case).

The statute defines a "covered employee" as a current or former employee who is either (i) one of the five highest compensated employees of the organization for the tax year, or (ii) was a covered employee for any preceding tax year. The term "covered employee" is defined in the statute based on the term "compensation" (not the term "remuneration"), thus creating ambiguity as to whether a determination of covered employees is based on the definition of remuneration in Section 4960 or another standard. Nonetheless, the Notice indicates (at section I.C.) that while the Treasury and the IRS considered using the compensation standards used to determine covered employees for Section 162(m) purposes, the Notice instead defines covered employees based on the definition of remuneration in Section 4960. Accordingly, Q&A 10 of the Notice states that the covered employees group is determined based on remuneration paid for services performed as an employee of the ATEO, including remuneration for services performed as an employee of a related organization with respect to the ATEO.

The Notice appears to treat an ATEO's officers as employees of the ATEO as long as the officers are treated as common law employees of a related organization, regardless of the amount of time such officers devote to the ATEO and regardless of whether they receive any additional compensation for these services. Under this reading of the Notice, the aggregate remuneration received by the ATEO's officers from all related employers will be considered when identifying the five highest compensated employees of the ATEO. Thus, employees of a related for-profit organization who serve as volunteer director-officers of an ATEO (such as a treasurer or secretary) would be deemed common law employees of an ATEO for purposes of Section 4960. As such, they may become the ATEO's covered employees, and the portion of their remuneration exceeding $1 million would be subject to excise taxes under Section 4960, even though the employees are not compensated for services provided to the ATEO.[3] Given this result, it would appear that the Notice interprets the statute in ways not contemplated by Congress.

Consistent with the statute, the Notice confirms that once an employee is a covered employee, he or she will remain a covered employee of an ATEO in perpetuity. The Notice states that any position that a covered employee's status can be terminated in subsequent tax years is not consistent with a good faith, reasonable interpretation of the statute. Taken to its extreme, this could mean that, even if a covered employee is no longer affiliated with an ATEO in future years, remuneration from the related for-profit employer for services rendered to that employer could be included in determining the aggregate remuneration for purposes of Section 4960 and the calculation of excise taxes. Moreover, if a former employee continues to receive certain deferred compensation from the for-profit employer exceeding $1 million, Section 4960 excise tax will be due.

The Notice contains (at Q&A 10(b)) a so-called "limited services exception," which provides that an employee is not one of the ATEO's five highest compensated employees if the ATEO pays less than 10% of the em-

1 2019-4 IRB 403.

2 Notice 2019-9, section I.B.

3 An exception to the excise tax under Section 4960 exists for compensation that is subject to deduction disallowance under Section 162(m). For public companies, one potential solution to the Section 4960 excise tax issue is to have only covered employees of the public company whose compensation is already subject to Section 162(m) serve as volunteers of the foundation, but that is not generally going to be practical.

ployee's total remuneration for services performed for the ATEO and all related organizations. However, if no ATEO in the group pays at least 10% of the total remuneration paid by the group, this exception does not apply to the ATEO that paid the most remuneration. How and whether this limited service exception, and its inapplicability, might be relevant to a volunteer officer of an ATEO who is a full-time employee of a related corporation is not clear.

Under the Notice (at Q&A 14), liability for excise taxes is proportionately allocated between common law employers based on the amount paid by them for services provided to them, regardless of the legal identity of the payor. The Notice stresses that taking the view that a for-profit entity related to an ATEO is not liable for its share of the excise tax under Section 4960 is not consistent with a good faith, reasonable interpretation of the statute. Accordingly, it appears that under the interpretation of Section 4960 in the Notice, to the extent that a corporate employee is a bona fide volunteer at an ATEO, provides a de minimis amount of services to an ATEO, and does not receive any additional compensation for services provided to an ATEO, full liability for the excise tax would be allocated to the related for-profit entity. The Notice indicates that the entities may enter into reimbursement arrangements. While analysis of such an arrangement is outside the scope of this article, reimbursing a for-profit entity for Section 4960 excise taxes may result in violations of excise tax provisions applicable to private foundations under Chapter 42 of the Code.

Is There a Road to Compliance or Relief?

Section 4960 defines remuneration of a covered employee by an ATEO to include any remuneration paid with respect to employment with a related organization. However, it does not sufficiently clarify whether the entire remuneration or only a portion related to the provision of services to an ATEO is includable. The definition of excess remuneration is similarly ambiguous. The Notice requires including the aggregate remuneration received by an employee, irrespective of who receives the employee's services. However, the statute could be interpreted to aggregate only the remuneration in respect of services to an ATEO or benefitting an ATEO, regardless of the identity of the employer or the payor. The legislative history of Section 4960 does not reveal any intent by Congress to apply excise tax provisions to remuneration from for-profit entities in respect of services unrelated to an ATEO. The Notice does not list this position as inconsistent with a good faith, reasonable interpretation of the statute.

Furthermore, Section 4960(c)(4) defines remuneration subject to the excise tax as including any remuneration paid with respect to employment with a related organization. However, Section 4960(c)(2) does not define covered employees using the same term. Section 4960 also does not clearly define an employee of an ATEO for purposes of the covered employee definition. Consistent with the statute, it would seem possible to interpret Section 4960 as not applying to volunteer officers of an ATEO who are fully paid by a related taxable entity for services to such an entity on the basis that those volunteers are not employees of the ATEO.

Further, discussions with administrative and congressional staff indicate that, in structuring Section 4960 and the Notice, the focus was not on the impact of the excise tax on volunteer officers of a corporate foundation. Instead, the focus was on high-paid football coaches of tax-exempt universities and making sure they did not funnel compensation through related entities to avoid the excise tax on remuneration in excess of $1 million. The IRS itself appears to recognize that it went too far in its interim guidance. The IRS has received comments requesting guidance addressing situations in which employees of a for-profit entity provide volunteer services to a related corporate foundation and whether such a structure may result in the application of the Section 4960 excise tax to the remuneration from the private entity exceeding $1 million. The IRS acknowledges that it had not considered this common scenario when the Notice was drafted. Proposed regulations are in the process of being drafted by the IRS. In the meantime, the IRS has encouraged ATEOs and related taxpayers to comment on the issue and suggest solutions. Such comments have been received by the IRS, which reportedly is taking these comments and concerns into account in the proposed regulations. While awaiting such guidance, ATEOs and related organizations should be able to develop a reasonable, good faith position that does not require payment of an excise tax in connection with volunteer officers.

Taxpayers may decide to reduce the number of directors on the board of a related ATEO or

change the governing documents to remove the ability to make board appointments, so that the for-profit and nonprofit organizations are no longer related. However, this drastic approach is likely to dilute or distort the charitable mandate. Furthermore, the issue would only be addressed prospectively once such changes are made.

Conversations with taxpayers about possible compliance mechanisms revealed support for a de minimis services exception under which volunteers providing limited services to an ATEO (below 10% of their working hours) would not be included for purposes of identifying covered employees. The IRS may address this approach in its proposed regulations by expressly stating that such employees are not deemed common law employees of an ATEO, whether or not they serve as officers of an ATEO. Another way to implement this suggestion would be to expand the limited services exception by specifically carving out the individuals providing such limited services to an ATEO from the ATEO's covered employees.

The IRS may also implement a "bona fide volunteer" test: if an employee of a for-profit organization would receive the same compensation regardless of his or her involvement with the related ATEO, such an employee would not be considered a common law employee of the ATEO for purposes of the statute. Compliance with the bona fide volunteer exception would not be burdensome as long as companies have consistent records of compensation of their employees prior to, during, and after the provision of services to the related ATEO. The IRS can require filing Form 4720 showing zero excise tax due and a simple certification by an officer of a for-profit organization that a bona fide volunteer exception applies.

Where does this leave the affected community? The taxpayers who choose to fully comply with the Notice would devote resources to implementing byzantine compliance structures. The taxpayers who are willing to risk taking positions that are not consistent with the Notice, but are reasonable, good faith interpretations of the statute, may devote resources to procuring relevant legal opinions. In either case, the funds that would otherwise be deployed for charitable purposes would instead be consumed by compliance or transaction costs. Some smaller taxpayers may decide to curtail their philanthropic activities in the future.

There will be no winners if the IRS does not expressly exclude corporate volunteers at related foundations from the reach of Section 4960. The affected community should continue to be vocal about this issue and urge the IRS to design a workable approach. While the formal comment period for the Notice has expired, the IRS is still interested in hearing from stakeholders and should be engaged via conferences, industry group letters, CLE events, and publications. ■