August 28, 2020

Hon. Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Comments on Proposed Regulations Under Section 4960

Dear Commissioner Rettig:

Enclosed please find comments regarding the proposed regulations under Section 4960. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Joan C. Arnold  
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury  
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ABA SECTION OF TAXATION
COMMENTS CONCERNING
PROPOSED REGULATIONS UNDER SECTION 4960
TAX ON EXCESS TAX-EXEMPT ORGANIZATION
EXECUTIVE COMPENSATION

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Gil J. Ghatan, Alexander L. Reid, Chelsea R. Rubin, David A. Shevlin and Maura L. Whelan of the Exempt Organizations Committee of the Section, and by Marc Fossee, Brian Gallagher and Robert Neis, of the Employee Benefits Committee of the Section. The Comments were reviewed by Carolyn O. Ward, Chair of the Exempt Organizations Committee and Andrew Liazos, Chair of the Employee Benefits Committee. The Comments were further reviewed by Ellen P. Aprill of the Section’s Committee on Government Submissions, and by Kurt L. Lawson, Vice Chair for Government Relations the Tax Section.

Although the members of the Section may have clients who might be affected by the federal income tax principles addressed by these Comments, no such member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: August 28, 2020
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I. Executive Summary

These Comments respond to Prop. Treas. Reg. §§ 53.4960-0 through 53.4960-5 (the “Proposed Regulations”)\(^1\) issued by the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) under section 4960.\(^2\) They supplement, in part, comments on section 4960 that we submitted on August 28, 2018 (the “2018 Comments”),\(^3\) and July 12, 2019 (the “2019 Comments”).\(^4\) However, they focus on the guidance in the Proposed Regulations, and also address several new topics.

All three sets of comments reflect our understanding of the policy goals behind the enactment of section 4960. Namely, in large part, we understand that section 4960 was enacted to achieve “parity” between tax-exempt organizations and taxable employers regarding the deduction limits in sections 162(m) and 280G. In summary, section 162(m) disallows deductions by publicly held corporations of the compensation of certain key employees in excess of $1 million, and section 280G disallows deductions by payors of


\(^{2}\) Unless otherwise indicated, all references to a “section” or “§” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” references are to the Treasury regulations promulgated under the Code, all as in effect (or in the case of Proposed Regulations, as proposed) as of the date of these Comments.

\(^{3}\) ABA Tax Section, Guidance Regarding Sections 512(a)(7) and 4960, available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/082818comments.pdf. The 2018 Comments identified a number of interpretive issues under section 4960, before any guidance had been issued, and recommended ways to resolve them. They were submitted in response to a request for comments on guidance implementing section 4960 in the 2017-2018 Priority Guidance Plan, Third Quarter Update, issued May 9, 2018.

\(^{4}\) ABA Tax Section, Comments on Section 4960, Notice 2019-9 and Volunteers Providing Services to Tax-Exempt Organizations, available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/071219comments.pdf. The 2019 Comments provided examples illustrating some of the ways in which an employee of a taxable entity might volunteer or otherwise perform services for a tax-exempt organization (such as a company foundation) without any additional remuneration. They were submitted in response to public requests by representatives of Treasury and the Service for fact patterns involving exempt organizations potentially affected by section 4960 that could inform their analysis of that section and, more generally, a request in Notice 2019-09, 2019-04 I.R.B. 403 (the “Notice”), for comments on topics addressed in the Notice and any other issues arising under section 4960. The 2019 comments were not intended to provide technical analysis of the topics addressed in the Notice.
certain “excess parachute payments” to certain shareholders, officers, and highly compensated individuals.\(^5\)

Specifically, these Comments make the following recommendations:

- We recommend that the final Regulations provide that (i) for purposes of determining the highest-compensated employees of an applicable tax-exempt organization ("\textit{ATEO}\") (and, thus, its covered employees), only remuneration paid (directly or indirectly) by the ATEO, or, at a minimum, only remuneration related to the employment of an employee by an ATEO, including remuneration paid by a related person or governmental entity of an ATEO, be taken into consideration, and (ii) for purposes of computing the tax under section 4960(a), only remuneration related to the employment of an employee by an ATEO, including remuneration paid by a related person or governmental entity of an ATEO, be taken into consideration.

- If Treasury and the Service determine not to follow our recommendation above, we recommend that (i) the final Regulations provide that the substance of the “limited hours exception”\(^6\) and the “nonexempt funds exception,”\(^7\) be applied not only for purposes of determining an ATEO’s five highest-compensated employees (and, thus, its covered employees), as under the Proposed Regulations, but also for purposes of determining remuneration, and (ii) substantially similar exceptions be incorporated into Treas. Reg. § 53.4960-2(b)(2).

- If Treasury and the Service determine not to follow our recommendations above, we recommend that the final Regulations (i) clarify that, when a covered employee is not an employee of the ATEO for the applicable year, remuneration paid by a related organization for services performed for the related organization is not treated as paid or payable by the ATEO and, therefore, is not included in remuneration potentially subject to tax under section 4960(a), and (ii) include examples to clarify this point explicitly.

- We recommend that the final Regulations (i) incorporate, in addition to a one-year assessment period, an alternative three-year (or longer) rolling measurement period, explained in more detail below, that an ATEO may elect to use for each of the Limited Hours Exception, the Nonexempt Funds Exception, and the “limited services exception,”\(^8\) (ii) change the name of the Limited Hours Exception to the “limited remuneration exception,” and (iii)


\(^6\) See Prop. Treas. Reg. § 53.4960-1(d)(2)(ii) (the “\textit{Limited Hours Exception}\”).

\(^7\) See id. § 53.4960-1(d)(2)(iii) (the “\textit{Nonexempt Funds Exception}\”).

\(^8\) See id. § 53.4960-1(d)(2)(iv) (the “\textit{Limited Services Exception}\”).
replace the 10%-hours-of-service threshold under the Limited Hours Exception with the 50%-hours-of-service threshold from the Nonexempt Funds Exception.

- We recommend that the final Regulations clarify that the relevant remuneration for purposes of meeting the “minor services exception”9 is remuneration from the ATEO.

- We recommend that the final Regulations (i) define “control” for purposes of section 4960(c)(4)(B) based on the controlled group rules in section 414(b) and (c) and the regulations thereunder (including their “greater than 80%” threshold), rather than those in section 512(b)(13)(D) and Treas. Reg. § 1.512(b)-1(l)(4), and (ii) remove “employees” from the list of individuals who may be considered “representatives” of another organization under the test for control of a nonstock organization.

- We recommend that the final Regulations permit, but not require, related employers to determine net earnings on previously paid remuneration on an aggregate basis by treating all earnings and losses on the previously paid remuneration of related employers as paid by the ATEO.

- We recommend that the final Regulations, or the Preamble to the Proposed Regulations (the “Preamble”),10 confirm that remuneration does not include amounts that are not includible in gross income pursuant to the $10,000 de minimis exception under section 7872(c)(3).

- We recommend that the final Regulations (i) provide that an employer may make a reasonable, good faith allocation between remuneration for providing medical services and remuneration for providing nonmedical services, without regard to the form of remuneration, and (ii) explain that the employer may make a reasonable, good faith allocation not only with respect to contributions and benefits, but also with respect to earnings, under a deferred compensation plan.

- We recommend that Treasury and the Service (i) issue guidance of general applicability, or at a minimum include language in the preamble to the final Regulations under section 4960, permitting taxpayers to use any reasonable approach for coordinating sections 4960 and 162(m) in circumstances where it is not known whether a deduction for such remuneration will be disallowed under section 162(m) by the due date of the relevant Form 4720, and deeming the two approaches described in the Preamble to be reasonable, and (ii) adopt a third approach, under which section 162(m) would not disallow a taxpayer’s

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9 See id. § 53.4960-1(e)(1) (the “Minor Services Exception”).

deduction for remuneration that the taxpayer treated as remuneration under section 4960 in a previous taxable year.

- We recommend that the final Regulations extend the rule in the Proposed Regulations for “regular wages” as defined in Treas. Reg. § 31.3402(g)-1(a) to deferrals that are not treated as deferred compensation under section 409A or 457 because they are paid within the section 409A “short-term deferral” period, and benefits under bona fide severance pay, death and disability plans.

- We recommend that the final Regulations (i) relieve a common law employer from any penalties or interest that might otherwise apply for failure to report or pay the section 4960 excise tax attributable to compensation or benefits of which it had no knowledge because they were paid or provided by a section 3401(d)(1) statutory employer, but only if it made bona fide attempts to obtain the necessary information about the compensation or benefits from the section 3401(d)(1) statutory employer if and when it became aware of them, and (ii) provide guidance on what may be considered a bona fide attempt for this purpose.

- We recommend that the Regulations under section 6011 be amended, or a revenue procedure be issued, to allow any one of the related employers to file a return and pay the tax owed under section 4960 on behalf of all the related employers who are liable for any portion of the tax for that taxable year.

- We recommend that the final Regulations apply to taxable years beginning after December 31 of the calendar year that ends at least six months after the date on which the final Regulations are published in the Federal Register.

II. Inclusion of Remuneration by a Related Person or Governmental Entity to Determine an ATEO’s Five Highest-Compensated Employees and Remuneration Paid by an ATEO

A. Issue

In relevant part, section 4960(a)(1) imposes a tax equal to the product of the rate of tax under section 11 and “so much of the remuneration paid … by an [ATEO] for the taxable year with respect to employment of any covered employee in excess of $1,000,000” (emphasis added).

Section 4960(c)(2) defines a covered employee as “any employee (including any former employee) of an [ATEO] 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” (emphasis added).
Section 4960(c)(4)(A) provides that “[r]emuneration of a covered employee by an [ATEO] shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity.”

In the Proposed Regulations, Treasury and the Service have adopted the view that total remuneration from an ATEO and any related person or governmental entity, whether or not that remuneration is in any way related to employment of an employee by an ATEO, is taken into consideration for determining both (i) the five highest-compensated employees of the ATEO (subject to certain limited exceptions) and (ii) remuneration by the ATEO for purposes of computing the tax imposed under section 4960(a). Specifically, under the Proposed Regulations, “[t]he highest-compensated employees of an ATEO for the taxable year are identified on the basis of the total remuneration paid during the applicable year to the employee for services performed as an employee of the ATEO or any related organization.”\(^\text{11}\) In addition, “[r]emuneration paid … by a related organization to an ATEO’s employee during an applicable year for services performed as an employee of the related organization is treated as paid (or payable) by the ATEO…”\(^\text{12}\)

**B. Recommendation**

We recommend that the final Regulations provide that, for purposes of determining an ATEO’s highest-compensated employees (and, thus, its covered employees), only remuneration paid (directly or indirectly) by the ATEO, or, at a minimum, only remuneration related to the employment of an employee by an ATEO, including remuneration paid by a related person or governmental entity of an ATEO, be taken into consideration. We further recommend that the final Regulations provide that, for purposes of computing the tax under section 4960(a), only remuneration related to the employment of an employee by an ATEO, including remuneration paid by a related person or governmental entity of an ATEO, be taken into consideration.\(^\text{13}\)

**C. Explanation**

We believe that including remuneration that is unrelated to the employment of an employee by an ATEO for purposes of determining the ATEO’s highest-compensated employees (and, thus, its covered employees) and for purposes of computing the tax under section 4960(a) is not required by the statutory text, is inconsistent with Congressional intent, and is unnecessary for achieving the goal of parity with section 162(m).

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12 Id. § 53.4960-2(b)(2) (emphasis added).
13 This was an alternative recommendation in Part II.B.8(c)(4) of the 2018 Comments, applicable if Treasury and Service decided not to allow an ATEO’s highest-compensated employees to be determined on a controlled-group basis.
Only an ATEO can have a “covered employee” under section 4960(c)(2). We believe that the statutory text “highest-compensated employees of the organization” in section 4960(c)(2)(A) thus should be read to concern only compensation paid by the ATEO, directly or indirectly (e.g., through reimbursement of another entity). In the alternative, we believe that only the compensation attributable to the services rendered by the employee to the ATEO, determined in good faith, should be relevant. We believe that the statement in section 4960(c)(4)(A) that “remuneration of a covered employee by an [ATEO] shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity” (emphasis added) should not override either plain reading. Rather, we believe that section 4960(c)(4)(A) assumes that a determination of the ATEO’s covered employees already has been made. Therefore, we believe it is circular to read section 4960(c)(4)(A) as requiring inclusion of remuneration paid to a covered employee of an ATEO by a related person or governmental entity for purposes of determining an ATEO’s highest-compensated employees (and, thus, its covered employees).

Likewise, we believe that section 4960(c)(4)(A) should be read together with section 4960(a)(1), and be interpreted as if it read as follows: “remuneration of a covered employee by an [ATEO] shall include any remuneration paid by any related person or governmental entity with respect to the [ATEO’s] employment of such covered employee.” This interpretation would ensure that all remuneration with respect to a covered employee’s employment by an ATEO, including remuneration paid by a related organization of an ATEO, be included in computing the tax under section 4960(a). It also would avoid the illogical – and, we believe, unintended – results that might follow from the interpretation in the Proposed Regulations of taxing remuneration paid by persons who are not ATEOs for services that are entirely unrelated to an ATEO, merely because of a possibly quite tenuous relationship between the remunerating person with an ATEO. As discussed in greater detail below, the Proposed Regulation’s Limited Hours Exception and Nonexempt Funds Exception might not address these unintended consequences. They provide no relief with respect to individuals who have been classified as covered employees in prior years (and, thus, remain so classified indefinitely).

We believe that to include compensation unrelated to the individual’s services rendered to the ATEO is inconsistent with the statute’s goals of preventing the waste of tax-exempt assets and ensuring parity with section 162(m). While the Limited Hours Exception and the Nonexempt Funds Exception might mitigate the impact of an alternative reading in certain situations, we maintain that the proper policy outcome is to look only to the compensation attributable to the services rendered to the ATEO. We believe that such a reading is entirely consistent with the statutory language of section 4960(c)(4)(A).

D. Alternative Recommendation

If Treasury and the Service determine not to follow our recommendation above, we recommend that the final Regulations provide that the substance of the Limited Hours Exception and Nonexempt Funds Exception be applied not only for purposes of
determining an ATEO’s five highest-compensated employees (and, thus, its covered employees), as under the Proposed Regulations, but also for purposes of determining remuneration. We recommend incorporating substantially similar exceptions in Treas. Reg. § 53.4960-2(b)(2), when it is finalized.

E. Explanation of Alternative Recommendation

The Limited Hours Exception and the Nonexempt Funds Exception afford only narrow, one-time exclusions of certain employees for purposes of determining an ATEO’s five highest-compensated employees (and, thus, its covered employees). Neither exception provides any relief from the backwards-looking nature of the statute or the fact that, once designated as a covered employee, an individual never can lose that designation.14 We question whether excluding remuneration paid by a related person or governmental entity of an ATEO in one context (i.e., determining the ATEO’s five highest-compensated employees), while including it in another (i.e., determining remuneration for purposes of computing the tax under section 4960(a)) is appropriate. When an individual previously has been classified as a covered employee, but would not be so classified in a subsequent year (but for the previous classification) based on the Limited Hours Exception or the Nonexempt Funds Exception, we do not see a justification for including the remuneration paid by an ATEO’s related person or governmental entity for purposes of computing the section 4960(a) tax in the subsequent year.

F. Additional Alternative Recommendation

If Treasury and the Service determine not to follow our recommendations above, we recommend that the final Regulations clarify that, when a covered employee is not an employee of the ATEO for the applicable year, remuneration paid by a related organization for services performed for the related organization is not treated as paid or payable by the ATEO and, therefore, is not included in remuneration potentially subject to tax under section 4960(a). We recommend that the final Regulations include examples to clarify this point explicitly.

G. Explanation of Additional Alternative Recommendation

Under section 4960(c)(2)(B) and Prop. Treas. Reg. § 53.4960-1(d), once an individual becomes a covered employee of an ATEO for a taxable year, that individual will be a covered employee of that ATEO for all future taxable years. An individual who has become a covered employee of an ATEO during a taxable year might cease employment with that tax-exempt organization and switch to being employed and paid solely by a related taxable organization. For example, an ATEO might elect to form a wholly-owned for-profit subsidiary to conduct an activity that would otherwise be an unrelated trade or business for the exempt organization, and the covered employee might be transferred to the new for-profit subsidiary to operate the new business. As another

14 I.R.C. § 4960(c)(2)(B).
example, an individual could become a covered employee of an ATEO that is a corporate foundation because the organization has fewer than five employees total and so all of its employees for the taxable year become covered employees. That individual might subsequently transfer to a position in the corporation that sponsors the foundation.

Prop. Treas. Reg. § 53.4960-4(a) says the ATEO is taxable on excess remuneration for each covered employee. As discussed above, the exceptions in the Proposed Regulations for individuals who perform “no more than” a certain number of hours of work for an ATEO or who are compensated exclusively by a taxable organization that is not controlled by the ATEO, are exceptions to covered employee status only. The exceptions have no effect on whether remuneration paid by a related taxable organization to an individual who has become a covered employee of an ATEO in a prior year is subject to tax in the current taxable year. Rather, Section 4960(c)(4)(C) provides that remuneration shall include remuneration paid with respect to employment of such employee by any related person.

However, Prop. Treas. Reg. § 53.4960-2(b)(2) states that remuneration paid by a related organization “to an ATEO’s employee during an applicable year for services performed as an employee of the related organization is treated as paid (or payable) by the ATEO.” This statement appears to clarify that when a covered employee is not an employee of the ATEO for the applicable year, remuneration paid by a related organization for services performed for the related organization is not treated as paid or payable by the ATEO and, therefore, is not included in remuneration potentially subject to tax under section 4960(a).

We believe that this is the correct result, but unfortunately this clarification is implicit rather than explicit. Therefore, we recommend that the final Regulations provide examples to make clear where a covered employee is employed solely by a related taxable organization, remuneration is not treated as paid by the ATEO. We also recommend that the examples clarify that if a covered employee leaves employment with an ATEO and begins employment with a related for-profit organization in the middle of an applicable year, remuneration paid by the related for-profit organization for services performed for the related for-profit organization after the change in employment has occurred is not treated as paid or payable by the ATEO. Consistent with the rest of the statute and the rest of the Proposed Regulation, examples would provide that amounts paid include amounts no longer subject to a substantial risk of forfeiture.

Example 1: C is employed in taxable year 1 solely by X, an ATEO. X has only 3 employees in taxable year 1. As a result, C is a covered employee for taxable year 1. Z is a for-profit taxable corporation that selects all of the directors of C and therefore is a related organization with respect to X. In taxable year 3, C leaves employment with X and begins employment solely with Z. In taxable year 8, C continues to be an employee solely of Z and is not an employee of C. C’s remuneration for applicable year 8 exceeds $1 million. No part of the

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remuneration paid to C in applicable year 8 is treated as paid by X in applicable year 8.

*Example 2:* D is one of the five highest-compensated employees of X, which is an ATEO, for taxable year 1. Therefore, D is a covered employee of X for taxable year 1 and all subsequent taxable years. D is a calendar year taxpayer. X pays all of D’s remuneration with respect to the services D performs for X. All of D’s remuneration paid by X is taken into account for purposes of determining whether X is liable for tax under section 4960(a) for taxable year 1 with respect to D.

In March of taxable year 3, D ceases employment with X and begins employment with Z, a for-profit taxable corporation that controls X and, therefore, is a related organization with respect to X. D is employed solely by Z for the rest of taxable year 3 and is paid by Z for services performed for Z. No part of the remuneration paid by Z with respect to the services D performed for Z while employed by Z is taken into account as remuneration paid by X for taxable year 3, and, therefore Z is not liable for tax under section 4960(a) with respect to D for taxable year 3.

*Example 3:* D is one of the five highest-compensated employees of X, which is an ATEO, for taxable year 1. Therefore D is a covered employee of X for taxable year 1 and all subsequent taxable years. D is a calendar year taxpayer. Z, a for-profit taxable corporation that controls X and, therefore, is a related organization with respect to X, pays D for performing services for X. All of D’s remuneration paid by Z is taken into account as remuneration paid by X for purposes of determining whether tax is owed under section 4960(a) with respect to D as a covered employee of X. As all of D’s remuneration for taxable year 1 is paid by Z, if tax is owed with respect to D’s remuneration for taxable year 1, Z will be liable for all of the tax.

In March of taxable year 3, D ceases employment with X and begins employment with Z. D is employed solely by Z for the rest of taxable year 3 and is paid by Z for services performed for Z. Only the remuneration paid by Z with respect to the services D performed for X while D was employed by X and no part of the remuneration paid by Z with respect to the services D performed for Z while employed by Z is taken into account as remuneration for purposes of determining whether tax is owed under section 4960(a) for taxable year 3 with respect to D as a covered employee of X.

### III. Exceptions to Covered Employee Status

#### A. Issue

Each of the Limited Hours Exception, the Nonexempt Funds Exception, and the Limited Services Exception to determining an ATEO’s highest-compensated employees (and, thus, its covered employees), produces cliff liability. Exceeding the service restriction by just one hour or the remuneration limit by just one dollar in a single taxable year results in permanent status as a covered employee under the Proposed Regulations.
In addition, the exceptions provide only a narrow pathway for excluding remuneration paid by a controlled taxable related organization. For example, they distinguish sharply between remuneration paid to an ATEO employee from a taxable related organization that controls the ATEO (and therefore is eligible for the 50%-hours-of-service threshold under the Nonexempt Funds Exception) and remuneration paid from a taxable related organization that is controlled by the ATEO (and therefore is eligible for the 10%-hours-of-service threshold only under the Limited Hours Exception).

B. Recommendation

We recommend that the final Regulations incorporate, in addition to a one-year assessment period, an alternative three-year (or longer) rolling measurement period that an ATEO may elect to use for each of the Limited Hours Exception, the Nonexempt Funds Exception, and the Limited Services Exception. Specifically:

- The alternative to the Limited Hours Exception as currently proposed would apply, if, in the aggregate, over the current applicable year and the prior two applicable years, the individual performed services as an employee of the ATEO and all related ATEOs for no more than 10% of his or her total hours worked as an employee of the ATEO and all related organizations, such individual would be disregarded for purposes of determining the ATEO’s five highest-compensated employees for the taxable year. This alternative would allow for an individual who, for example, performed services as an employee of an ATEO and all related ATEOs equal to 8% of total hours worked as an employee of the ATEO and all related organizations in year 1, equal to 7% in year 2, and equal to 15% in year 3 to potentially avoid becoming a covered employee in year 3 by aggregating total hours worked across the three-year period.

- The alternative to the Nonexempt Funds Exception as currently proposed would apply, if, in the aggregate, over the current applicable year and the prior two applicable years, the individual performed services as an employee of the ATEO and all related ATEOs for less than 50% of his or her total hours worked as an employee of the ATEO and all related organizations, such individual would be disregarded for purposes of determining the ATEO’s five highest-compensated employees for the taxable year.

- The alternative to the Limited Services Exception as currently proposed would apply, if, in the aggregate, over the current applicable year and the prior two applicable years, the total remuneration paid to that individual by the ATEO is either (i) less than 10% of total remuneration paid to that individual by the ATEO and all related organizations and at least one related ATEO paid at least 10% of total remuneration over that period or (ii) less than the total remuneration paid to that individual by at least one related ATEO and no related ATEO paid at least 10% of total remuneration paid to that individual by the ATEO and all related organizations.
We also recommend that the final Regulations change the name of the Limited Hours Exception. The Limited Hours Exception does not, in fact, turn on the number of hours worked by an individual. Rather, it measures percentage remuneration paid by the ATEO as compared with total remuneration paid by the ATEO and all related organizations. We recommend retitling it as the “limited remuneration exception.”

C. Explanation

The strict requirements of the Limited Hours Exception, the Nonexempt Funds Exception, and the Limited Services Exception and the annual tests they apply will create many opportunities for inadvertent non-adherence, and the consequences of that will be multiplied by the fact that once an individual becomes a covered employee of an ATEO such individual remains a covered employee in perpetuity. The attendant record-keeping and tracking requirements to avoid these consequences will create significant administrative burdens, even where a relationship is intended to be structured so as to fit within one or more of the exceptions. The proposed alternative measuring periods for the three exceptions would provide ATEOs an important, albeit limited, window within which to manage existing and future employment arrangements to potentially avoid employees inadvertently becoming covered employees.

D. Additional Recommendation

Regardless of whether Treasury and the Service determine to follow our recommendation above, we recommend that the final Regulations replace the 10%-hours-of-service threshold under the Limited Hours Exception with the 50%-hours-of-service threshold from the Nonexempt Funds Exception.

E. Explanation of Additional Recommendation

The 10%-hours-of-service threshold under the Limited Hours Exception fails to capture many common arrangements between ATEOs and controlled taxable subsidiaries that are not structured to avoid the section 4960 tax. For example, many tax-exempt organizations opt to spin-off unrelated activities into controlled taxable organizations, with some overlapping personnel often for a transition period. Under the Proposed Regulations, even if the ATEO pays an overlapping employee no remuneration, remuneration from the taxable subsidiary would be taken into account unless the employee devotes no more than 10% of his or her total hours worked to the ATEO. In contrast, an individual simultaneously working for the same ATEO and a taxable related organization that controls the ATEO would not have his or her compensation from the related organization taken into account if his or her total hours worked for the ATEO are less than 50% for total hours worked for the ATEO and all related organizations.

The higher 50% threshold of the Nonexempt Funds Exception is not available for employees of controlled taxable related organizations on the premise that the funds of a “taxable” related organization that is controlled by the ATEO are somehow “exempt” funds. We question this premise. Section 4960 makes no distinction between the direction of “control” when defining a related organization – an organization is related
whether the ATEO controls the organization or is controlled by the organization. Moreover, the income and assets of a taxable organization do not become those of a tax-exempt organization merely because the tax-exempt organization controls the taxable organization. Net income of a taxable related organization is subject to tax whether that related organization is controlled by or controls the ATEO. Such funds are not “exempt” unless and until they are distributed to the ATEO.

IV. Minor Services Exception

A. Issue

The Minor Services Exception provides that “an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration is not considered to be an employee of the corporation solely due to the individual’s status as an officer of the corporation.”16 The source of the relevant remuneration for purposes of meeting the Minor Services Exception is unclear. For example, it is unclear whether an individual qualifies if he or she receives remuneration from a related person or governmental entity and then volunteers his or her time as an officer of an ATEO (and performs no services or only minor services).

B. Recommendation

We recommend that the final Regulations clarify that the relevant remuneration for purposes of meeting the Minor Services Exception is remuneration from the ATEO. We recommend that this be done by revising the penultimate sentence of Prop. Treas. Reg. § 53.4960-1(e)(1) as follows:

An employee generally also includes an officer of a corporation, but an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration from the corporation is not considered to be an employee of the corporation solely due to the individual’s status as an officer of the corporation. (emphasis added)

C. Explanation

The Proposed Regulations define “employee” in accordance with section 3401(c) and Treas. Reg. § 31.3401(c)-1. Treas. Reg. § 31.3401(c)-1(f) provides in relevant part as follows:

Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is

16 Id. § 53.4960-1(e)(1) (emphasis added).
entitled to receive, directly or indirectly, any remuneration is not considered to be an employee of the corporation.

We believe that the clear implication of this language is that an individual serving as an officer of a corporation who receives remuneration from that corporation for services performed as an officer of that corporation is treated as an employee of that corporation.

V. Definition of “Control” for Purposes of Identifying “Related Organizations”

A. Issue

Section 4960(c)(4)(B), clauses (i) and (ii), provide that a person or governmental entity is “treated as related to an [ATEO]” if such person or governmental entity “(i) controls, or is controlled by, the organization,” or “(ii) is controlled by one or more persons which control the organization.”

“Control” is not defined in the statute. The Proposed Regulations use the definition of “control” set forth in section 512(b)(13)(D) and Treas. Reg. § 1.512(b)-1(l)(4), which use a “greater than 50%” threshold for determining control. By contrast, the definition of “control” set forth in section 414(b) and (c) and the regulations thereunder generally use a “greater than 80%” threshold. According to the Preamble, the Proposed Regulations do so because the definition under section 512(b)(13)(D) and its “greater than 50%” threshold “generally” align with the definition of control for purposes of the Form 990, (2) align more closely with other exempt organization control tests, and (3) prevent abuse that might occur in the section 4960 context if a higher percentage threshold for control were adopted.

Under the Proposed Regulations, as under Treas. Reg. § 1.512(b)-1(l)(4), “control” of a nonstock organization by a person or governmental entity exists if more than 50% of the trustees or directors of the nonstock organization are either representatives of, or directly or indirectly controlled by, the person or governmental entity. An employee is deemed to be a representative of a person or governmental entity for this purpose unless “the employee does not act as a representative of the person or governmental entity and that fact is reported in the form and manner prescribed by the Commissioner in forms and instructions.”

B. Recommendation

We recommend that the final Regulations define “control” for purposes of section 4960(c)(4)(B) based on the controlled group rules in section 414(b) and (c) and the

18 Preamble at 35,754.
20 See Treas. Reg. § 1.414(c)-5(b).
regulations thereunder (including their “greater than 80%” threshold), rather than those in section 512(b)(13)(D) and Treas. Reg. § 1.512(b)-1(l)(4).

In addition, we recommend that the final Regulations remove “employees” from the list of individuals who may be considered “representatives” of another organization under the control test for purposes of more fully addressing the issue of accidental control in the context of nonstock organizations.

C. Explanation

We believe that Section 4960 is best understood as a mechanism to drive accountability for the use of an ATEO’s exempt funds. We believe that, accordingly, the definition of control should be consistent with this understanding of the statute, which the Service and Treasury already have acknowledged in the Proposed Regulations through the adoption of the Nonexempt Funds Exception.

We believe that the Proposed Regulations are inconsistent with this understanding. The purpose of section 512(b)(13) is to prevent a taxable corporation from avoiding income tax by making deductible payments to a tax-exempt organization it controls—a very different purpose from section 4960. Moreover, the Proposed Regulations cherry-pick the broad control test from section 512(b)(13)(D). For example, they fail to include the requirement in section 512(b)(13)(D) that the controlled entity be engaged in a transaction with the tax-exempt organization that reduces the taxable income of the controlled taxable entity. In other words, section 512(b)(13)(D) requires both control and an abusive transaction, but the Proposed Regulations adopt only the control portion of the rule. In our view, the section 414(b) and (c) rules present a more appropriate standard for the definition of control under section 4960(c)(4)(C) than do the section 512(b)(13) rules because the purpose of the section 414(b) and (c) rules is to treat related parties as a single employer, which is the same purpose as that of section 4960(c)(4)(C). Furthermore, the highly developed and still-evolving regulations under section 414(b) and (c) would provide taxpayers useful, contemporary guidance on how the section 4960 rules ought to work in situations that they do not otherwise directly address. By contrast, the regulations under section 512(b)(13)(D) are outdated, refer to dead letter law, and have not been revised since April 1972, thereby eliminating the ongoing utility of looking to those regulations for further guidance.

In our view, the definition of control in the Proposed Regulations also is inappropriate because it imposes significant and unnecessary administrative burdens on ATEOs. The Preamble to the Proposed Regulations suggests that adopting the section 512(b)(13)(D) control test aligns with the Form 990 and therefore reduces burdens on ATEOs to identify related organizations and calculate compensation for other section 4960 purposes.21 In practice, however, this burden reduction is illusory. For example, many organizations are identified as “related” for Form 990 purposes without in fact being “related” under the Form 990 test. Instead, they are identified as “related” out of

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21 See Preamble at 35,754.
an abundance of caution. The consequences of over-identifying on the Form 990 are minimal, but over-identifying under section 4960 could lead to liability for the excise tax. Adopting the section 512(b)(13)(D) control test also does not reduce administrative burdens on organizations because the Form 990 rules for identifying highest compensated employees and calculating compensation already differ significantly from the section 4960 rules. Aligning those portions of the Form 990 rules with the section 4960 rules would, in our view, be a more effective way to reduce administrative burdens than the approach taken in the Proposed Regulations.

The 2018 comments also recommended defining “control” using the rules in section 414(b) and (c). They recommended substituting the 80% control threshold in those rules with a 50% threshold, as well. However, the latter recommendation was made in the absence of any other guidance, in particular the subsequent guidance on how to identify an ATEO’s highest-compensated employees, and before the tax-exempt community had begun to focus in earnest on the practical challenges of implementing section 4960. Therefore, we no longer recommend that approach.

Whether or not the Service and Treasury adopt our recommendation to use the section 414(b) and (c) control test rather than the section 512(b)(13)(D) control test, we recommend that the final Regulations more comprehensively address the issue of accidental related organizations. We believe that the Proposed Regulations are further inconsistent with the understanding of section 4960 as a mechanism to drive accountability for the use of an ATEO’s exempt funds in that they create a significant risk of accidental control in the context of nonstock organizations. We believe the exception in the Proposed Regulations for low-level employees places an additional reporting burden on ATEOs, and recommend instead that the final Regulations address the root of the issue by removing “employees” altogether from the list of deemed representatives and focus the representative test on the actual decision-makers in the organization.

As noted in the Preamble, a representative test is replicated across the control tests under section 512(b)(13)(D), section 414(c), and the Form 990. All three treat employees of an organization as being a representative of that organization when the employee is serving as a director or trustee of another organization. However, we believe all three versions are based on the rules originally created to address abusive earning-stripping transactions between related organizations under section 512(b)(13)(D), when the statute explicitly defined control under a higher 80% control threshold. In that

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22 See Part II.B.9.

23 Preamble at 35,755.

24 See I.R.C. § 512(b)(13) before it was amended by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 787, which cross-referenced the definition of control in section 368(c). See also the transmittal memorandum dated February 1, 1972, that accompanied T.D. 7177, 37 Fed. Reg. 7,088 (April 8, 1972), which adopted Treas. Reg. § 1.512(b)-1(l): It explained that Treas. Reg. § 1.512(b)-1(l)(4), relating to the definition of control in the case of a non-stock organization, “was added to the proposed
context, the expansive list of individuals who may be acting as a representative balanced a higher control threshold. The same is true for the representative test under section 414(c), which when it was adopted used (and still uses) an 80% control threshold. The Form 990 reiterated this anti-abuse rule without, in our view, any record of abuse in these other contexts. Since the adoption of that definition in the Form 990 reporting rules, organizations have confronted the issue of accidental related organizations, but the opportunity for public notice and comment is much more limited for forms. Furthermore, the consequences under the Form 990 (i.e., unnecessary reporting) are much less onerous than the consequences under section 4960 (additional taxes). We believe that the length of time that the rule has been in place and the duplication of the rule across several areas need not prevent the section 4960 final Regulations from addressing this longstanding issue.

VI. **Net Losses on Previously Paid Remuneration**

A. **Issue**

The Proposed Regulations, like the Notice, provide that the remuneration of an employee includes net earnings on remuneration that has been included in income because it is vested, but that remains unpaid (referred to in the Proposed Regulations as a “previously paid remuneration”). Under the Proposed Regulations, the amount of net earnings or losses on previously paid remuneration is determined on an employee-by-employee basis, and “losses accrued on previously paid remuneration paid by one employer do not offset earnings accrued on previously paid remuneration paid from another employer.” For virtually all other purposes, however, remuneration paid by related employers to the employee of an ATEO is aggregated, and the ATEO is treated as paying the remuneration that is paid by related organizations.

B. **Recommendation**

We recommend that the final Regulations permit, but not require, related employers to determine net earnings on previously paid remuneration on an aggregate basis by treating all earnings and losses on the previously paid remuneration of related employers as paid by the ATEO.

C. **Explanation**

In groups of related taxable and tax-exempt organizations, related organizations often provide separate deferred compensation plans to their employees and, therefore, a single employee who works (or has worked) for multiple related employers might have several deferred compensation plans. These deferred compensation plans often differ

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considerably, with some being defined benefit plans and others being defined contribution plans, and, among the defined contribution plans, very different investment options. As a result, a single employee might accrue significant earnings in a year under one or more deferred compensation plans, while incurring significant losses in other deferred compensation plans.

Under the rules as currently proposed, the losses from plans maintained by one employer cannot offset the earnings from plans maintained by other employers. We believe that this approach is inconsistent with the rules that apply to other forms of remuneration and is likely to cause a significant overstatement of employee remuneration. Thus, it could result in the imposition of tax when none should be due.

As noted above, the Proposed Regulations generally require all remuneration paid to the employee of an ATEO by a related organization to be aggregated for purposes of determining the employee’s total remuneration for a year, and treat remuneration paid by related organizations as paid by the ATEO, except as provided in Prop. Treas. Reg. § 54.4960-1(d)(2)(ii) and (iii). We believe that allowing related employers to aggregate earnings and losses on previously paid remuneration would be consistent with these rules.

We also believe that allowing taxpayers to extend the aggregation rules to earning and losses would prevent the overstatement of remuneration. Specifically, if only net earnings on previously paid remuneration are aggregated across all related employers while net losses are isolated to particular employers, the remuneration of some employees will be inflated under certain circumstances.

While we understand that Treasury and the Service might have concerns about making the aggregation of earnings and losses on previously paid remuneration by related employers optional, we believe that those concerns could be addressed relatively easily. Related organizations could be required to aggregate (or not aggregate) earnings and losses consistently from year to year. Changes could be allowed only infrequently, for example, every three years, and in response to changes in the composition of the group of related organizations that must aggregate (or not aggregate) earnings and losses.27 We encourage Treasury and the Service to allow this flexibility to accommodate changes in the ability of a group of related organizations to share timely data on earnings and losses on previously paid remuneration.

VII. Compensation-Related Loans of Less Than $10,000

A. Issue

The Proposed Regulations state: “Remuneration includes amounts includible in gross income as compensation for services as an employee pursuant to a below-market

\footnote{An example of such changes could include the addition of a new organization to the group of related organizations or the adoption of a deferred compensation plan by an existing member of a group of related organizations that had not previously had such a plan.}
loan described in section 7872(c)(1)(B)(i) (compensation-related loans).”28 Neither the text of the Proposed Regulations nor the Preamble mentions section 7872(c)(3), which provides a de minimis exception from imputed interest requirements for any day on which the aggregate outstanding amount of loans between the borrower and lender does not exceed $10,000. As a result, it is unclear whether remuneration includes amounts that are not required to be included in gross income under section 7872 pursuant to section 7872(c)(3).

B. Recommendations

We recommend that the final Regulations, or the Preamble to the final Regulations, confirm that remuneration does not include amounts that are not includible in gross income pursuant to the $10,000 de minimis exception under section 7872(c)(3).

C. Explanation

The Preamble helpfully explains why remuneration includes certain below-market loans.29 Specifically, it explains that the authority for these loans not being subject to federal income tax withholding is section 7872(f)(9) rather than an exclusion from the definition of “wages” under section 3401(a) (the starting point for the definition of “remuneration” under section 4960(c)(3)).30 Given the specificity of the explanation in the Preamble, which does not mention the $10,000 de minimis exception under section 7872(c)(3), some practitioners have questioned whether Treasury and the Service would agree that remuneration does not include amounts that are not required to be included in gross income under section 7872 pursuant to the $10,000 de minimis exception.

While we are confident that Treasury and the Service agree that remuneration does not include amounts that are not required to be included in gross income under section 7872 pursuant to the $10,000 de minimis exception, we recommend that the final Regulations specifically affirm this conclusion.

VIII. Deferred Compensation Allocable to Medical Services

A. Issue

Section 4960(c)(3)(B) provides that remuneration does 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. The Proposed Regulations provide that the employer must make a reasonable, good faith allocation between remuneration for providing medical services and remuneration for providing nonmedical services.31 The Proposed Regulations do not specifically address

29 Preamble at 35,755.
30 Id.
whether deferred compensation may be allocable to medical services and thereby excluded from remuneration.

B. Recommendation

We recommend that the final Regulations provide that an employer may make a reasonable, good faith allocation between remuneration for providing medical services and remuneration for providing nonmedical services, without regard to the form of remuneration. We further recommend that the final Regulations explain that the employer may make a reasonable, good faith allocation not only with respect to contributions and benefits, but also with respect to earnings, under a deferred compensation plan.

C. Explanation

The Proposed Regulations can be read as allowing an employer to make reasonable, good faith allocations between remuneration for providing medical services and remuneration for providing nonmedical services for all forms of remuneration, including deferred compensation. Because the Proposed Regulations do not address deferred compensation specifically, however, some practitioners might question whether the same standard applies for remuneration under deferred compensation plans.

IX. Remuneration Paid to a Covered Employee for Which a Deduction is Disallowed under Section 162(m)

A. Issue

Section 4960(c)(6) provides that remuneration the deduction for which is not allowed by reason of section 162(m) shall not be taken into account for purposes of section 4960. The Proposed Regulations provide general rules for coordination of sections 4960 and 162(m).32 The Preamble, however, notes that the Proposed Regulations do not address the coordination of sections 4960 and 162(m) in circumstances where it might not be known at the time remuneration is treated as paid whether a deduction for such remuneration will be disallowed under section 162(m).33 Deferred compensation, for example, might vest (and thus be included in remuneration) many years before it is paid (and thus otherwise deductible).

The Preamble suggests two possible approaches for addressing this problem in “future regulations.”34 Under the first approach, the taxpayer excludes an amount from remuneration under section 4960 if the amount might reasonably be expected to be nondeductible under section 162(m) for a subsequent taxable year.35 The Preamble

32 Id. § 53.4960-2(f).
33 Preamble at 35,758.
34 Id. at 35,759.
35 Id.
identifies several practical issues presented by this approach. Under the second approach, the taxpayer offsets remuneration subject to tax under section 4960 in a later taxable year by the amount that was treated as excess remuneration in a previous taxable year. The Preamble notes that this approach would benefit only a taxpayer that pays excess remuneration in the later year.

The Preamble requests comments on these two possible approaches, including how they might be offered as alternatives, as well as any other approach that might be helpful in coordinating sections 4960 and 162(m).

B. Recommendations

We recommend that Treasury and the Service issue guidance of general applicability, or at a minimum include language in the preamble to the final Regulations under section 4960, permitting taxpayers to use any reasonable approach for coordinating sections 4960 and 162(m) in circumstances where it is not known whether a deduction for such remuneration will be disallowed under section 162(m) by the due date of the relevant Form 4720, and deeming the two approaches described in the Preamble to be reasonable.

We also recommend a third approach, under which section 162(m) would not disallow a taxpayer’s deduction for remuneration that the taxpayer treated as remuneration under section 4960 in a previous taxable year.

C. Explanation

We believe the purpose of section 4960(c)(6) is clear: to avoid double taxation, remuneration should not be both subject to taxation under section 4960 and nondeductible under section 162(m). The Preamble thoughtfully explains how this purpose might be thwarted where it is unknowable that section 162(m) will disallow the taxpayer’s deduction for remuneration until after the end of the limitation period for claiming a refund of the section 4960 tax paid on that remuneration. However, by referring to “future regulations” it implies that neither of the two approaches, nor any other approach that might be suggested in the requested comments, will be included in the final Regulations under section 4960.

Unless the “future regulations” are published before the end of the period of limitations for the first taxable year section 4960 applied (taxable years beginning after

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36 Id.
37 Id. Under both approaches, the remuneration would nevertheless be taken into account for purposes of identifying the five highest-compensated employees.
38 Preamble at 35,759.
39 Id.
40 Id. at 35,758.
December 31, 2017), taxpayers will need guidance upon which they may rely pending the publication of such “future regulations.” For example, a calendar year taxpayer generally would need to claim a refund for its 2018 taxable year by May 15, 2022.

Under our third approach for coordinating sections 4960 and 162(m), section 162(m) would not disallow a taxpayer’s deduction for remuneration that it treated as remuneration paid under section 4960 in a previous taxable year. We understand that this third approach would likely require the “future regulations” to amend not only the final Regulations under section 4960 but also the Regulations under section 162(m). In the meantime, however, taxpayers could be allowed to apply a general rule based on a reasonableness standard and could choose from three specific approaches each of which would be deemed to be reasonable.

X. **Applicable Taxable Year in Which Remuneration is Treated as Paid**

A. **Issue**

The Proposed Regulations provide that the taxable year in which remuneration is treated as paid depends on whether the remuneration is a “regular wage” as that term is defined under Treas. Reg. § 31.3402(g)-1(a), or something else. Treas. Reg. § 31.3402(g)-1(a) defines a “regular wage” as a wage subject to withholding that is “paid at a regular hourly, daily, or similar periodic rate … for the current payroll period or at a predetermined fixed determinable amount for the current payroll period.” The Proposed Regulations treat a “regular wage” as paid on the date the covered employee actually or constructively receives it, but treat any other remuneration as paid on the date it vests. Other remuneration that falls outside the definition of a “regular wage” includes annual bonuses, long-term incentive pay, business expense reimbursements, nonqualified deferred compensation (including amounts included in gross income under section 457(f)), noncash fringe benefits, and severance pay.

Except for “regular wages” and certain deferred compensation, the payment timing rule for remuneration in the Proposed Regulations is different from the payment timing rules that apply to remuneration that ATEOs track for any other reason. ATEOs track the remuneration they pay their employees for a variety of reasons, but primarily so that they can determine the proper amounts of income and FICA taxes to withhold, and determine the proper amounts to report on Form W-2 and in Part VII and Schedule J to the Form 990. The timing rules that apply for these other purposes are described in detail in our 2018 Comments. To summarize, remuneration generally is subject to income and FICA tax withholding, and is reported on Form W-2 and in Part VII and Schedule J to the Form 990, in the year they are actually or constructively received, with a few specific exceptions. For example, the instructions to Form W-2 specifically require benefits under a section 457(f) plan to be reported in Box 1 when they vest. Also, elective deferrals to qualified plans and nonqualified deferred compensation subject to

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41 Prop. Reg. § 53.4960-2(c)(1).
section 3121(v)(1) and (2), respectively, are subject to FICA taxes and are reported in Boxes 3 and 5 when they vest. Finally, the Form 990 requires the reporting of “reportable compensation,” which generally means compensation reported on Form W-2 in Box 1 or Box 5 (whichever is larger), and also requires the reporting of “other compensation,” which includes “deferrals of compensation” under any deferred compensation plans that are not reported in Box 1 or Box 5, such as stock options and unvested awards, employer contributions to section 401(a) plans, unvested benefits under section 457(b) and 457(f) plans, and (for defined benefit plans only) a reasonable estimate of the increase or decrease in actuarial value of plan benefits. Outside of these exceptions, remuneration generally is not reported when it accrues or vests. Specifically, deferrals that are not treated as deferred compensation under section 409A or 457 because they are paid within the section 409A “short-term deferral” period, and bona fide severance, death, and disability benefits, are withheld on and reported when they are paid rather than when they vest.

These differences will require ATEOs (and related organizations) to adopt new information collection systems and procedures that, we believe, will be burdensome to administer and probably result in increased operation failures in determining the applicable excise taxes. Organizations that have relied on the existing timing rules may be trapped with plan designs that will increase the amount of excise taxes the organization will owe and under current regulations have no options to amend or redesign those plans consistent with the new inclusion timing rules for section 4960 remuneration.

B. Recommendation

We recommend that the final Regulations extend the rule in the Proposed Regulations for “regular wages” as defined in Treas. Reg. § 31.3402(g)-1(a) to deferrals that are not treated as deferred compensation under section 409A or 457 because they are paid within the section 409A “short-term deferral” period, and benefits under bona fide severance pay, death and disability plans.43

C. Explanation

We believe that this recommendation would reduce substantially the administrative burden and potential for errors created by the broad timing rule in the Proposed Regulations, while affecting a limited range of remuneration. Employers account for, and employers and employees think of, short-term deferrals and bona fide severance, death, and disability benefits, in much the same way they do regular wages. Presumably that is one reason why Treasury and the Service created exceptions for them in the regulations under sections 409A and 457 (and elsewhere). While the exclusion for

43 We recommended that Treasury and the Service treat remuneration as “paid” when it vests only in the case of amounts actually subject to section 457(f) in Part II.B.5 of the 2018 Comments. We made that recommendation, in part, to match the reporting of “reportable compensation” on Form 990 and thus reduce the administrative burden of the timing rule. However, we understand the government’s reasons for rejecting this approach in the Notice and the Proposed Regulations, including the treatment of deferred compensation not subject to section 457(f), and are making a more limited recommendation here.
short-term deferrals would give employers some additional flexibility to determine when remuneration will be taken into account, we believe that opportunity would be limited, would exist already for other forms of remuneration by way of negotiation over the vesting schedule, and would be justified by the improved compliance and reduced administrative burden that would result.

We believe that Treasury and the Service have the authority under section 4960 to create the existing exception in the Proposed Regulations for “regular wages,” and believe that they equally would have the authority to extend that exception to the few additional forms of remuneration described above.44

XI. Relief When Taxpayer Cannot Obtain Information on, or Has No Knowledge of, Payments by Section 3401(d)(1) Employer

A. Issue

The Proposed Regulations provide that the employer generally is the common law employer without regard to whether there is another entity (called the “section 3401(d)(1) employer” or “statutory employer” in the employment tax context) that has control of the payment of the wages that could give rise to excess remuneration or excess parachute payments.45 The common law employer is the “taxpayer” that has liability for reporting and paying the section 4960 excise tax, but it might find these tasks difficult or impossible to do correctly if it either cannot obtain information regarding, or has no knowledge of, compensation or benefits paid or provided by the statutory employer.

B. Recommendation

We recommend that the final Regulations relieve a common law employer from any penalties or interest that might otherwise apply for failure to report or pay the section 4960 excise tax attributable to compensation or benefits of which it had no knowledge because they were paid or provided by a section 3401(d)(1) statutory employer, but only if it made bona fide attempts to obtain the necessary information about the compensation or benefits from the section 3401(d)(1) statutory employer if and when it became aware of them. We also recommend that the final Regulations provide guidance on what may be considered a bona fide attempt for this purpose.

C. Explanation

A section 3401(d)(1) statutory employer could be a related organization with respect to the common law employer, or it could be an entity or organization (such as a payroll agent, professional employer organization, or other third party payor) that is not a

44 Certainly nothing in section 3402(g), which merely permits Treasury and the Service to issue regulations modifying the manner and amount of income tax withholding for certain types of wages, would prohibit this.

related organization. In most cases, the common law employer will have knowledge of the compensation and benefits provided to its employees regardless of whether another entity has control over them. However, there might be situations when a common law employer is unable to obtain full information about the compensation and benefits provided by the other entity. The section 3401(d)(1) statutory employer might refuse to provide the information, or the common law employer might simply have no knowledge that a third party paid or provided compensation or benefits to its employee. In those situations, the common law employer might not have the information needed to identify its covered employees or determine whether an excise tax is due under section 4960. Provided the common law employer makes reasonable attempts to obtain information about compensation and benefits provided to its employees once it became aware of them, we do not believe that it should be penalized for failing to properly identify its covered employees or determine whether excess remuneration or excess parachute payments have been paid and, therefore, failing to report or pay all or a portion of its allocable section 4960 excise tax.

XII. Payment of Allocated Tax

A. Issue

Section 4960(c)(4)(C) provides that “[i]n 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.” Prop. Treas. Reg. § 53.4960-4(c) provides for allocation of liability consistent with section 4960(c)(4)(C) where remuneration for a taxable year is paid during an applicable year by more than one employer to a covered employee.

Treasury Decision 985546 amended Treas. Reg. § 53.6011-1(b) such that it now provides that “[e]very person (including a governmental entity) liable for tax imposed by … section[ ] 4960(a) … shall file an annual return on Form 4720, “Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code,” and shall include therein the information required by such form and the instructions issued with respect thereto.” As applied, Treas. Reg.§ 53.6011-1(b) now requires multiple related organizations each to file a Form 4720 when each has paid a portion of the excess remuneration paid to a covered employee for an applicable year. Experience gained since the final Regulations under section 6011 were finalized has shown that the requirement for each related organization to file its own separate return can be burdensome. The Proposed Regulations confirm that there might be numerous situations in which a covered employee will be treated as having multiple employers, each of which is separately liable for a portion of the tax under section 4960(a). Furthermore, the fact that

the $1 million threshold for the payment of excess remuneration is not indexed for inflation will increase the number of situations over time in which tax must be paid.

B. Recommendation and Explanation

To relieve the filing burden on taxpayers, we recommend that the Regulations under section 6011 be amended, or a revenue procedure be issued, to allow any one of the related employers to file a return and pay the tax owed under section 4960 on behalf of all the related employers who are liable for any portion of the tax for that taxable year. Consistent with section 4960(c)(4)(C) and the Proposed Regulations, each employer would remain liable for its allocated portion of the tax, and any return filed reporting tax liability under section 4960 would need to report the name, employer identification number, and allocated portion of liability for each related employer.

XIII. Proposed Applicability Date of Regulations

A. Issue

The Proposed Regulations state that they will apply to “taxable years beginning after December 31 of the [calendar year in which the Treasury Decision adopting these rules as final regulations is published in the Federal Register].” \(^{47}\) However, the Preamble indicates that the final Regulations are proposed to apply to “taxable years beginning on or after the date the final regulations are published in the Federal Register.” \(^{48}\) In addition, the Preamble explains that Treasury and the Service understand that the date during the calendar year on which the final Regulations are issued might affect the time that an ATEO and any related organizations will have to familiarize themselves with the final Regulations and to respond with adjustments to compensation structures or other adjustments. \(^{49}\) It therefore requests comments on the burdens anticipated and the timeframe expected to be necessary to implement the final Regulations (taking into account that the statutory provisions already are effective). \(^{50}\)

B. Recommendation

We recommend that the final Regulations apply to taxable years beginning after December 31 of the calendar year that ends at least six months after the date on which the final Regulations are published in the Federal Register.

C. Explanation

As a preliminary matter, we note an inconsistency between the Proposed Regulations and the Preamble. The Preamble indicates that the final Regulations will

\(^{47}\) *Id.* § 53.4960-5.

\(^{48}\) Preamble at 35,764.

\(^{49}\) *Id.*

\(^{50}\) *Id.*
apply to taxable years beginning on or after the date on which the final Regulations are published, while the Proposed Regulations indicate that they will apply to taxable years beginning after December 31 of the calendar year in which the final Regulations are published. For a taxpayer with a calendar year taxable year, the result would be the same. However, for a taxpayer with a fiscal year taxable year beginning between the date of publication and December 31, the applicable date would be different. For example, if final Regulations are published on June 30, 2021 and a taxpayer’s taxable year begins on October 1, under the Preamble, the final Regulations would apply to the taxpayer’s taxable year beginning on October 1, 2021, but under the Proposed Regulations, the final Regulations would not apply until the taxpayer’s taxable year beginning on October 1, 2022.

Additionally, because an ATEO’s applicable year is the calendar year ending with or within the ATEO’s taxable year, under the Preamble’s approach the ATEO in the above example would be faced with first applying the final Regulations to its applicable year of calendar year 2021, even if they were not published until midway through that year. Thus, we believe that the “December 31” concept incorporated into Prop. Treas. Reg. § 53.4960-5(a) is necessary and appropriate, and that the final Regulations should resolve the inconsistency between the Preamble and the Proposed Regulations by taking the approach in the Proposed Regulations.

Even if this is done, we believe that an additional delay is likely to be needed by most taxpayers. For example, if final Regulations are published in late December, calendar year taxpayers will have mere days or weeks to read, digest, and begin to apply them. Many ATEOs also have limited resources and slower decision-making processes than their for-profit counterparts, making such lead times difficult if not impossible to manage. Finally, if the ongoing global pandemic persists, and the majority of work is still being conducted remotely when final Regulations are issued, we anticipate that taxpayers’ response times will continue to be slower than usual.

Thus, we recommend that the final Regulations provide that the final Regulations be made applicable to taxable years beginning after December 31 of the calendar year which ends at least six months following the date on which the final Regulations are published in the Federal Register. For example, this recommendation would require that final Regulations be published no later than June 30, 2021, in order to apply to calendar year taxpayers on January 1, 2022.

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51 Id.
53 Id. § 53.4960-5(a).
54 Id. § 53.4960-1(c).
55 While this problem might not be the case for the ATEOs likely to actually trigger an excise tax under section 4960, all ATEOs are subject to these rules and will need to ensure compliance, for example, by tracking their covered employees.