IRS issues interim guidance on the TCJA excise tax imposed on tax-exempt organizations’ executive compensation payments

The Department of the Treasury and the Internal Revenue Service issued Notice 2019-09 (Notice) on Dec. 31, 2018, addressing the tax code Section 4960 excise tax imposed on applicable tax-exempt organizations and related organizations that pay excess compensation to certain employees. Section 4960 was enacted with Public Law 115-97 (2017) (commonly referred to as the “Tax Cuts and Jobs Act” or “TCJA”). It is one of the most controversial, potentially complex, and costly TCJA provisions imposed on tax-exempt organizations.

The Notice addresses rules on how tax-exempt organizations calculate and report the excise tax. It also makes clear that for-profit, taxable entities that are related to tax-exempt organizations may also be liable for excise taxes in certain circumstances.

This article discusses the critical provisions addressed in the Notice. It focuses, in particular, on the provisions that are applicable to large exempt organizations including health care systems, universities, and other exempt organizations comprised of multiple related entities including governmental and for-profit entities.

Background

Section 4960 imposes an excise tax at the Section 11 rate (currently, 21 percent) on an “applicable tax-exempt organization” calculated based on remuneration paid in a taxable year to a “covered employee” that (i) exceeds $1 million (excluding excess parachute payments), or (ii) is considered an excess parachute payment.

The Section 4960 excise tax is effective for taxable years beginning after Dec. 31, 2017.

Notice 2019-09

The Notice provides interim guidance on the application of the Section 4960 provisions. Until Treasury and the IRS issue proposed regulations or other future guidance, taxpayers may apply a reasonable, good faith interpretation of the statute. The positions reflected in the Notice are considered to be good faith interpretations of the statute; however, the Notice states that the failure to comply with certain positions is deemed not to be good faith compliance with the statute.

The Notice provides detailed rules related to the application of the Section 4960 excise tax provisions. Although not every provision addressed in the Notice will be applicable to every
exempt organization, every tax-exempt organization is subject to the Section 4960 excise tax provisions and will need to assess what rules are applicable and whether the organization is liable for the tax.

**What is an ‘applicable tax-exempt organization’?**

The Section 4960 excise tax is imposed on an “applicable tax-exempt organization” (ATEO) and, in certain circumstances, also may be imposed on a “related organization” to an ATEO. An ATEO is an organization that: (i) is exempt from taxation under Section 501(a); (ii) is a farmers’ cooperative described in Section 521(b)(1); (iii) has income excluded from tax under Section 115(1); or (iv) is a political organization described in Section 527(e)(1).

Governmental units (states, political subdivisions of a state, and integral parts thereof), including many state colleges or universities, are not included in the definition of an ATEO, unless they have received an IRS determination letter recognizing their tax-exempt status under Section 501(c)(3) (a “dual-qualified” organization). The Notice confirms that a dual-qualified governmental unit may relinquish its Section 501(c)(3) status, which would then exclude it from the ATEO definition. Other types of governmental entities that are separately organized and exclude amounts from income under Section 115(1) are included in the definition of an ATEO.

As discussed below, a governmental unit that is not considered an ATEO may still be subject to the Section 4960 excise tax if it is a related organization to an ATEO and employs a covered employee of that ATEO.

**Implications.** The Joint Committee on Taxation’s TCJA General Explanation (commonly referred to as the Bluebook) states that state colleges and universities were intended to be subject to the Section 4960 excise tax, but it acknowledges that a technical correction amendment to the statute may be needed to reflect this intent. Based on the guidance provided in the Notice, state colleges or universities that are dual-qualified should consider whether relinquishing their Section 501(c)(3) exempt status is merited in order to avoid being considered an ATEO subject to Section 4960. However, these governmental units should be aware that they may still be subject to the excise tax as related organizations, depending on the facts.

**When is the Section 4960 excise tax effective and what year is used to calculate the excise tax?**

The Section 4960 excise tax is effective for taxable years beginning after Dec. 31, 2017, and is based on a covered employee’s excess remuneration and excess parachute payments. The statute refers to remuneration paid in the “taxable year,” but does not specify whether the measurement of the remuneration is to the employer’s taxable year or the covered employee’s taxable year (i.e., the calendar year). The Notice resolves this issue by providing that the excise tax is calculated based on the excess remuneration and excess parachute payments paid in the
calendar year ending with or within the taxable year of the exempt organization or related organization subject to the tax.

Implications. Measuring the covered employees’ remuneration paid during the calendar year to determine who is a covered employee and to calculate the excise tax will simplify the ATEO’s administration of the tax. This rule also favors ATEOs and related organizations that have non-calendar year taxable years because the calculation of the excise tax in the initial year will be based only on the portion of the covered employee’s 2018 calendar year remuneration that is paid during the organization’s taxable year. For example, in the case of an ATEO with a taxable year commencing October 1, the ATEO would count only the portion of the covered employee’s remuneration (e.g., salary and vesting of deferred compensation) paid from Oct. 1, 2018, through Dec. 31, 2018, for purposes of calculating the excise tax for the taxable year that it is first subject to the excise tax (i.e., the taxable year from Oct. 1, 2018, through Sept. 30, 2019).

Which entities may be liable for the Section 4960 excise tax?

The common-law employer, as determined for federal tax purposes, is liable for the Section 4960 excise tax calculated based on excess remuneration or excess parachute payments paid to a covered employee. Only employees of an ATEO may qualify as covered employees. However, a related organization may also employ an ATEO’s covered employee, which could cause the related organization to be subject to the Section 4960 excise tax.

The determination of the common-law employer/employee relationship is a facts-and-circumstances test based on multiple factors. In the income tax withholding regulations, Treasury and the IRS state that an employer/employee relationship exists when “the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.” The regulations continue to provide that a service provider is considered a common-law employee if he or she is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. [Treas. Reg. Section 31.3401(c)-1(b).]

In Revenue Ruling 87-41, the IRS applied a "20-factor" test to determine the common-law employer. The IRS has applied the common-law employer test for examination purposes by reviewing three, broad standards—behavioral control, financial control, and legal control. (See, IRS training manual "Worker Classification Training Guidelines: Employee or Independent Contractor" (October 1996)).
The Notice emphasizes that an ATEO or related organization that is a common-law employer may not avoid its Section 4960 liability by using a third-party payroll arrangement, such as a payroll agent, common paymaster, statutory employer under Section 3401(d)(1), or a certified professional employer organization (certified PEO).

A “related organization” is a person or governmental entity if that person or entity generally: (i) controls, or is controlled by, the ATEO; (ii) is controlled by one or more persons which control the ATEO; (iii) is a supported organization, as defined in Section 509(f)(3) with respect to the ATEO; or (iv) is a supporting organization described in 509(a)(3) with respect to the ATEO. The “control” test is based on the definition in Section 512(b)(13)(D), which uses a 50-percent ownership threshold. This definition generally aligns with the definition of a related organization for purposes of the Form 990 annual reporting requirements.

**Implications.** Exempt organizations with multiple affiliated entities will need to determine which entity is the common-law employer. The entity that manages the payroll and issues the Forms W-2 to the service providers is not necessarily the common-law employer. Very often in hospital systems, universities and other large exempt organizations, one affiliated entity administers the payroll on behalf of other related entities; however, the entity administering the payroll often is not the actual common-law employer.

Prior to the enactment of Section 4960, identifying the actual common-law employer was not critical because the IRS generally did not challenge an employer’s payroll administration as long as the third-party providers were properly collecting and depositing the service providers’ income tax withholding and employment taxes and properly furnished the service providers with their Forms W-2 accurately reporting their wages and income. With the advent of the Section 4960 excise tax, the identification of which entity is the common-law employer is imperative. The amount of the excise tax imposed on a large, multiple entity exempt organization may vary dramatically depending on how the organization has arranged its employment relationships.

For example, compare: (i) Hospital System A that has consolidated its management function in a single, upper-tier entity that employs all of the executives who oversee the operations of the entire enterprise, including all of the separate, lower-tier hospitals entities, and (ii) Hospital System B that has decentralized its management functions with the result that the upper-tier entity employs only a select group of executives and each lower tier hospital entity employs its own CEO, CFO and other executives. Hospital System A (with the consolidated management function) may be subject to an excise tax on no more than its five highest compensated executives (its covered employees); whereas, Hospital System B (with the decentralized management structure) may be subject to a higher excise tax because the upper tier management entity may be subject to an excise tax on up to five of its highest compensated employees (its covered employees) and each lower tier hospital entity may also be subject to an excise tax on up to five of their highest compensated employees (the lower tier entities’ covered employees).
Another significant implication of the related organization rule is that a for-profit entity or a governmental entity may be subject to the Section 4960 excise tax if it is considered a common-law employer of a covered employee of an ATEO to which it is a related organization. For example, a tax-exempt hospital ATEO may have control of a for-profit, taxable laboratory services corporation that is treated as a related organization. The laboratory services corporation employs one of the hospital ATEO’s covered employees. In this case, the ATEO and the laboratory services corporation may both be liable for the Section 4960 excise tax. (See discussion below regarding “How is the liability for the excise tax determined if remuneration is paid to a covered employee of both an ATEO and a related organization?”)

**Who is a covered employee?**

A “covered employee” is any employee who is one of the ATEO’s five highest compensated employees in the current taxable year and any covered employee in any preceding taxable year beginning after Dec. 31, 2016. Any employee who is one of the ATEO’s five highest compensated employees would be considered a covered employee, even if the employee is not an officer of the ATEO. The determination of who is a covered employee is based on remuneration paid during the calendar year by the ATEO and any related organization.

A limited services exception applies if the ATEO pays less than 10 percent of the employee’s total remuneration for services performed as an employee of the ATEO and all related organizations. For example, assume that the CEO of a hospital system performs 95 percent of her services and receives 95 percent of her remuneration from parent entity A, which is an ATEO, and performs only 5 percent of her services and receives 5 percent of her remuneration as an officer of lower-tier hospital B, which is also an ATEO and is a related organization to A. Based on the rule requiring aggregation of remuneration paid by A and B, the CEO is determined to be a covered employee of A; however, the CEO would not be considered a covered employee of B because she received less than 10 percent of her total remuneration from B. Note, however, B is still considered the common-law employer of the CEO (a covered employee of A) and, therefore, would be required to file the Form 4720 and pay its allocable portion of the excise tax. (See discussion below “How is the excise tax reported and paid?”)

**Implications.** The “once a covered employee, always a covered employee” rule will require ATEOs to maintain an administrative system to track each covered employee, even if the ATEO is not liable for the excise tax in a particular year. The ATEO may be liable for the excise tax in a later year and will need to know which employees are considered covered employees.

ATEOs also will need to establish a system to track remuneration paid to their employees by related organizations to determine which employees are considered covered employees.

**How is remuneration determined?**

As discussed above, remuneration for purposes of identifying who is a covered employee includes remuneration paid by an ATEO and a related organization. Remuneration is defined as...
wages, within the meaning of Section 3401(a) excluding designated Roth after-tax contributions. Under the Section 3401(a) rules, remuneration does not include payments to or from a retirement plan that is qualified under Section 401(a), 403(b), 408(p), or 457(b). However, remuneration does include nonqualified deferred compensation awards made to employees of a tax-exempt organization when the award is no longer subject to a substantial risk of forfeiture (i.e., vested), in accordance with the Section 457(f) rules. Remuneration also includes an excess parachute payment; however, a parachute payment is not subject to the excise tax as excess remuneration if it is also subject to the excise tax as an excess parachute payment.

Remuneration does not include remuneration paid to a licensed medical professional (including a veterinarian) that is directly related to the performance of medical and veterinary services by such professional. The Notice narrowly defines amounts that may be excluded from application of the excise tax rules by providing that excluded remuneration is limited to remuneration for services that constitute “medical care,” defined as services for the diagnosis, cure, mitigation, treatment, or prevention of disease, including services for the purpose of affecting any structure or function of the body. Remuneration for teaching or research is not excluded, unless it can show that the services meet the “medical care” definition. Hospital systems and other health care ATEOs will need to establish a system to make a reasonable, good faith allocation of remuneration for medical care services and remuneration for administrative and all other services.

Remuneration does not include compensatory amounts paid to a covered employee of a covered health insurance provider (CHIP) for which the compensation deduction is disallowed under Section 162(m)(6) or amounts paid to a covered employee of a publicly held corporation for which the compensation deduction is disallowed under Section 162(m)(1). However, compensation paid to a covered employee of a CHIP or a publicly held corporation for which the deduction is not disallowed under Section 162(m) is considered remuneration for purposes of Section 4960.

**Implications.** ATEOs will need to set up administrative rules in their payroll systems to ensure that they properly track amounts that are considered remuneration paid by the ATEO and the related organization for purposes of identifying their covered employees.

For a health care system with a related organization that is a taxable covered health insurance provider subject to the Section 162(m)(6) deduction disallowance rules, the ATEO and the CHIP will need to determine what, if any, portion of a covered employee’s compensation is subject to the deduction disallowance rules and, therefore, would not be treated as remuneration for purposes of Section 4960.

*When is remuneration treated as paid for purposes of identifying a covered employee and calculating the excise tax?*

Remuneration is treated as paid on the date that the amounts are no longer subject to a
substantial risk of forfeiture (i.e., vested) within the meaning of Section 457(f)(3). The amount of the remuneration treated as paid on the vesting date is the present value of the future payments which the employee has a legally binding right to receive. (The Notice provides a detailed discussion on how to determine the present value of the compensation award.) Remuneration is treated as “previously paid remuneration” for a taxable year if, by the close of the calendar year ending with or within that taxable year, the amount is not actually or constructively paid. (See discussion below regarding application of the “quasi-grandfather rule.”) Earnings and losses on previously paid remuneration are generally determined under mark-to-market rules set forth in the Notice. Net earnings are treated as paid at the close of the calendar year in which they accrue.

The rule that remuneration is treated as paid on the vesting date applies equally to compensatory awards made to employees of tax-exempt employers and taxable employers. In the case of a taxable employer, tax rules generally provide that deferred compensation and equity-based awards are not included in an employee’s income until the amounts are actually or constructively paid. Despite the income inclusion rules that apply in the case of compensatory awards made by taxable employers to their employees, the Notice concludes that, for purposes of the Section 4960 excise tax, a taxable employer’s deferred compensation and equity-based awards are treated as payments of remuneration in the year the awards become vested.

**Implications.** The rule that remuneration is treated as paid when the amounts are vested (i.e., previously paid remuneration) creates a quasi-grandfather rule for the ATEOs’ covered employees’ previously paid remuneration—including compensatory awards that vested prior to the Section 4960 effective date—that was not actually or constructively paid prior to that date. For example, in the case of an employer with a calendar year taxable year, the present value of a nonqualified deferred compensation award that was vested as of Dec. 31, 2017, is treated as previously paid remuneration for the 2017 taxable year and would not be subject to the excise tax that becomes effective with the 2018 taxable year. If the deferred compensation was not actually or constructively paid in 2017, only the future vested earnings on the award would be treated as remuneration in 2018 and future years when calculating the excise tax.

The rule that treats compensatory awards as remuneration when the award becomes vested will create some interesting questions for taxable related organizations that employ an ATEO covered employee and compensate the employee with equity-based awards. For example, assume a tax-exempt university controls a taxable, for-profit research corporation that employs one of the university’s covered employees and awards stock options to the employee. The Notice does not address how stock option awards should be valued for purposes of Section 4960 when the employee vests in the awards.

*How are excess parachute payments determined?*

The excise tax may be imposed on an ATEO or related organization for any “excess parachute payment” made to a covered employee. The term “excess parachute payment” means an
amount equal to the excess, if any, of the total amount of any parachute payment over the portion of the base amount allocated to the payment.

A parachute payment is a compensatory payment to a covered employee if:

(i) The payment is contingent on the employee’s separation from employment with the employer, and
(ii) The aggregate present value of the payment equals or exceeds three times the employee’s “base amount”.

The term “parachute payment” does not include certain payments including the following: (i) payments made to or from a tax-qualified retirement plan, (ii) payments to a licensed medical professional for the performance of medical or veterinarian services; or (iii) payments made to an individual who is not a highly compensated employee as defined in Section 414(q).

The base amount is the employee’s average annualized taxable compensation for the five-year period ending before the year in which the separation from employment occurs.

The Notice provides that a payment is considered to be contingent on an employee’s separation from employment only if the facts and circumstances indicate that the payment was made solely as a consequence of the employee’s involuntary separation from employment. Hence, a “parachute payment” generally would be limited to severance and damages payments and certain non-compete payments that are agreed to solely in connection with an employee’s involuntary termination without cause by the employer. If a payment is accelerated or a substantial risk of forfeiture lapses as a result of an involuntary separation from employment, then only the value due to the acceleration is treated as a parachute payment. The Notice discusses how the accelerated payment or vesting is valued for purposes determined the amount of the parachute payment.

Based on the Section 4960 definitions and the guidance provided in the Notice, if a payment is considered a “parachute payment” because the payment is contingent on the employee’s involuntary separation from service and the aggregate present value of the payment exceeds three times the base amount, then the Section 4960 excise tax is imposed on the full amount in excess of the base amount. (The application of the Section 4960 excise tax is illustrated in Example 2 below.)

**Implications.** By limiting a parachute payment to amounts paid solely as a result of an involuntary termination of employment, the Notice significantly reduces the circumstances in which compensatory payments following an employee’s separation from service may be treated as a parachute payment potentially subject to the excise tax. Based on this definition, payments that the ATEO or related organization is obligated to pay when an executive resigns or otherwise terminates employment voluntarily, whatever the circumstances of the termination, would not be treated as parachute payments. Hence, deferred compensation amounts that were previously vested, but not actually or constructively paid until separation
from service, would not be treated as parachute payments. However, a payment to a covered employee pursuant to an employment agreement that entitles the employee to damages if involuntarily terminated from employment would be considered a parachute payment.

**How is the liability for the excise tax determined?**

An ATEO or a related organization is subject to an excise tax at a rate equal to the tax imposed under Section 11 (currently 21 percent) on remuneration in excess of $1 million or an excess parachute payment paid to a covered employee. If the excise tax is due on an excess parachute payment, the excess parachute payment is not counted in the calculation of remuneration in excess of $1 million.

The following examples provide simple illustrations of the calculation of the excise tax:

**Example 1 - Remuneration for year exceeds $1,000,000**

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>$950,000</th>
<th>$300,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base salary</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred compensation</td>
<td>$35,000</td>
<td></td>
</tr>
<tr>
<td>vesting</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,285,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Excess remuneration threshold</th>
<th>$1,000,000</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Excess remuneration</th>
<th>$(a) - (b)</th>
<th>$285,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Excess remuneration excise tax</strong></td>
<td>$(c) x 21%</td>
<td>$59,850</td>
</tr>
</tbody>
</table>

**Example 2 - Covered employee has "separation from employment"**

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>Potential Parachute Payments</th>
<th>Excise Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Salary</td>
<td>$600,000</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>$300,000</td>
<td></td>
</tr>
<tr>
<td>Deferred compensation vesting</td>
<td>$50,000</td>
<td></td>
</tr>
<tr>
<td>Accelerated vesting due to separation</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Severance payments</td>
<td>$2,000,000</td>
<td>$2,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,450,000</strong></td>
<td><strong>$2,500,000</strong> (b)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4x60 amount</th>
<th>$750,000</th>
<th>(c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3x base amount threshold</td>
<td>$2,250,000</td>
<td>(d)</td>
</tr>
<tr>
<td>Amount over / (under) threshold</td>
<td>$250,000</td>
<td>(e) = (b) - (d)</td>
</tr>
<tr>
<td>&quot;Excess parachute payment&quot; amount</td>
<td>$1,750,000</td>
<td>(f) = (b) - (c)</td>
</tr>
</tbody>
</table>

| Total remuneration less "excess parachute payment" | $1,700,000 | (h) = (a) - (f) |
| Excess remuneration subject to excise tax | $700,000 | (i) = $1,000,000 - (h) |
| "Excess parachute payment" excise tax | $367,500 | (g) |
| Additional excise tax amount | $147,000 | (j) |

| $514,500 | Total excise tax |

---

Example 2 -- Steps to calculate the Section 4960 excise tax when the covered employee has
both excess parachute payments and compensation in excess of $1,000,000:

- Step 1 -- Determine total amount of the parachute payments (i.e., payment contingent on an involuntary separation from employment) [(b) above].
- Step 2 - Determine the covered employee’s base amount (i.e., average annualized taxable compensation for the 5-year period ending before the year in which the separation occurs) [(c) above].
- Step 3 – Determine whether the parachute payments equal or exceed three times the base amount [(e) above].
- Step 4 – Determine the excess parachute payment amount (i.e., the total parachute payments minus the base amount) [(f) above]
- Step 5 – Calculate the excise tax on the excess parachute payment [(g) above; 21% x $1,750,000]
- Step 6 – Determine the total amount of remuneration less amount determined to be an excess parachute payment [(h) above; $3,450,000 (total remuneration) - $1,750,000 (excess parachute payment amount)]
- Step 7 – Determine the total amount in Step 6 in excess of $1,000,000 [(i) above]
- Step 8 – Calculate the excise tax on the excess remuneration determined in Step 6 [(j) above; 21% x $700,000]

**How is the liability for the excise tax determined if remuneration is paid to a covered employee of both an ATEO and a related organization?**

When remuneration is paid by an ATEO and one or more other employers of the covered employee that are related organizations, each employer is liable for the excise tax. The amount of the excise tax due by each employer is equal to an amount that bears the same ratio to the total excise tax as (i) the amount of the remuneration paid by the employer with respect to that covered employee, bears to (ii) the total amount of remuneration paid by the ATEO and all related organization employers.

If an employer is liable for an excise tax as an ATEO and also as a related organization for the same remuneration to a covered employee (i.e., because both entities are considered ATEOs), the employer is liable only for the greater of the excise tax it would owe as an ATEO or as a related organization.

The Notice sets forth the following steps for an ATEO to calculate the allocation of the excise tax liability:

   Step 1 – Calculate remuneration paid (other than excess parachute payments) for each covered employee, including remuneration from any related organization; if remuneration exceeds $1 million, the amount in excess of $1 million is subject to the excise tax.
Step 2 – Calculate the share of liability for each employer that employs a covered employee who was included in Step 1 as a fraction of the total excise tax liability that bears the same ratio to the total excise tax as the amount of remuneration paid by the employer bears to the total remuneration in Step 1.

Step 3 – Inform any related organization of its share of liability calculated in Step 2.

Step 4 – Obtain information on the ATEO’s share of liability as a related organization for any covered employee of another ATEO. If the ATEO is a related organization to more than one other ATEO, treat the ATEO’s highest share of liability as a related organization as its liability as a related organization for the covered employee.

Step 5 – Compare the ATEO’s liability as an ATEO in Step 2 to its share of liability as a related organization under Step 4 for each of the ATEO’s covered employees. The ATEO reports the greater of the share calculated under Step 4 or the share calculated under Step 2 as the ATEO’s share of liability for remuneration paid to the covered employee.

How is the excise tax reported and paid?

Each ATEO and related organization (including a for-profit, taxable related organization) that is liable for the excise tax under Section 4960 must report and pay the tax on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the tax code. When remuneration from a related organization is included to determine the excise tax, each ATEO and related organization must file a separate Form 4720 to report its share of the tax.

The Section 4960 excise tax must be paid and reported by filing the Form 4720 by the 15th day of the fifth month after the end of the employer’s taxable year. (Taxpayers are not required to make estimated tax payments.) For a calendar year taxpayer, Form 4720 for the 2018 taxable year, the first year when the excise tax is due, must be filed by May 15, 2019. For an ATEO with a taxable year ending June 30th (i.e., a non-calendar year taxpayer), the Form 4720 for the taxable year ending June 30, 2019, when the excise tax is first due would be due by Nov. 15, 2019.

The taxpayer may file a Form 8868, Application for Automatic Extension of Time to File an Exempt Organization Return to extend the Form 4720. However, the filing of the Form 8868 does not extend the time to pay the tax. To avoid interest and penalties, the employer must pay the tax due by the original due date of the Form 4720.

Final thoughts

The Treasury Department and IRS appear to be prepared to enforce the payment of the Section 4960 excise tax effective for taxable years beginning after Dec. 31, 2017. Large tax-exempt organizations with multiple entities in the organizational structure will need to assess which entities are considered the common-law employers and each of those employers will need to
identify their covered employees. The ATEOs that are employers will then need to determine whether their covered employees have remuneration in excess of $1 million or excess parachute payments that would result in a Section 4960 excise tax. Large tax-exempt organizations will need to be prepared for a complicated and time consuming analysis.