Outline

► Introduction
► Objective and purpose
► Key concepts
  ► Section 4960 overview
  ► Identifying covered employees
  ► Determining remuneration
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Objective and purpose
Objective and purpose

► Gain a basic understanding of Section 4960 – what it is and why it matters
► Begin to think through the application of Section 4960
► Identify functional groups that have responsibility for areas impacted by Section 4960 and identify next steps
Key concepts
Section 4960 overview

For tax years beginning after December 31, 2017, new Section 4960 to the Internal Revenue Code imposes a 21% excise tax on (1) remuneration in excess of $1 million paid within a taxable year or (2) any “excess parachute payments” paid to “covered employees” of any applicable tax-exempt organization (ATEO).

<table>
<thead>
<tr>
<th>BY THE NUMBERS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess Executive Remuneration</td>
<td>$1 million</td>
</tr>
<tr>
<td>Parachute Payments</td>
<td>Separation pay</td>
</tr>
<tr>
<td></td>
<td>$3x “base amount”</td>
</tr>
<tr>
<td>Excise Tax</td>
<td>21%</td>
</tr>
</tbody>
</table>
Section 4960 overview (continued)

1) One of the five highest compensated employees of the ATEO for the taxable year

2) Any individual who was a covered employee for any preceding taxable year beginning after December 31, 2016

**Limited Services Exception:** If an ATEO pays less than 10% of an employee’s total remuneration for services performed as an employee of the ATEO and all related organizations, then the employee is not treated as one of the ATEO’s five highest-compensated employees.

**Remuneration**

All “wages” as defined under Section 3401 (excluding designated Roth after-tax contributions) and non-qualified deferred compensation amounts when the amounts are no longer subject to a substantial risk of forfeiture (as defined under Section 457(f)) from an ATEO and related organizations in a calendar year.

**Exclusions**

1) Amounts paid to licensed medical professional for medical services (which includes services for the diagnosis, cure, mitigation, treatment, or prevention of disease, but not administrative or management services)

2) Payments to or from a retirement plan that is qualified under Section 401(a), 403(b), 408(p) or 457(b)
# Identifying covered employees

<table>
<thead>
<tr>
<th>GENERAL CONSIDERATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1</strong> Once a covered employee, always a covered employee (even if no longer one of the five highest-compensated employees)</td>
</tr>
<tr>
<td>• Creates administrative responsibility for ATEOs to track compensation to all covered employees</td>
</tr>
<tr>
<td>• Covered employees must be identified even if the ATEO does not pay more than $1M to any of its employees</td>
</tr>
<tr>
<td><strong>2</strong> Rules apply to any employee, not just officers</td>
</tr>
<tr>
<td><strong>3</strong> Covered employees are determined on an entity-by-entity basis rather than a controlled group basis</td>
</tr>
<tr>
<td>• Although each ATEO will have its own 5 covered employees, each individual entity must include remuneration paid by all related organizations when determining who is most highly compensated</td>
</tr>
<tr>
<td><strong>4</strong> Only an ATEO has covered employees, but a covered employee of an ATEO may also be an employee of a related organization and cause the related organization to be subject to the excise tax</td>
</tr>
<tr>
<td>• A taxable entity may be considered a related organization if control tests are satisfied (50% threshold)</td>
</tr>
<tr>
<td><strong>5</strong> Only a common law employee can be a covered employee. Who is a common law employee?</td>
</tr>
<tr>
<td>• The IRS outlined a “20-factor test” in Revenue Ruling 87-41 to evaluate whether a service provider is a common law employee. Factors generally fall into three categories: behavioral control, financial control and legal control</td>
</tr>
<tr>
<td>• A mere right to control the individual who performs the services is sufficient for common law employer status (actual control is unnecessary)</td>
</tr>
<tr>
<td>• ATEOs cannot avoid Section 4960 liability by simply using third-party payroll arrangements</td>
</tr>
</tbody>
</table>

(Continued on next slide)
# Identifying covered employees (continued)

## GENERAL CONSIDERATIONS

<table>
<thead>
<tr>
<th>IRS 20-factor test</th>
<th>11. Requirement for oral or written reports to be provided by the service provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Level of instruction from the service recipient</td>
<td>12. Schedule and frequency of payment</td>
</tr>
<tr>
<td>2. Amount of training from the service recipient</td>
<td>13. Payment of business and/or travel expenses</td>
</tr>
<tr>
<td>3. Degree of business integration with service recipient</td>
<td>14. Furnishing of tools, materials and equipment</td>
</tr>
<tr>
<td>4. Extent of personal services required of the service provider</td>
<td>15. Investment of facilities</td>
</tr>
<tr>
<td>5. Control over hiring, supervising and paying assistants</td>
<td>16. Realization of profit or loss</td>
</tr>
<tr>
<td>6. Continuity of relationship between the service recipient and service provider</td>
<td>17. Working for multiple persons or firms at the same time</td>
</tr>
<tr>
<td>7. Flexibility to set hours of work</td>
<td>18. Ability to make services available to the public</td>
</tr>
<tr>
<td>8. Requirement for full-time work</td>
<td>19. Service recipient’s control over discharging the service provider</td>
</tr>
<tr>
<td>9. Need for on-site work</td>
<td>20. Service provider’s right of terminating services</td>
</tr>
<tr>
<td>10. Dictation of the sequence of work</td>
<td></td>
</tr>
</tbody>
</table>

*Continued from prior slide*
## Determining remuneration

### GENERAL CONSIDERATIONS

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Remuneration includes amounts paid by a related organization that is the employer of the covered employee. Remuneration paid by another organization (whether related or not) on behalf of the ATEO is treated as paid by the ATEO.</td>
</tr>
<tr>
<td>2</td>
<td>Compensation paid to a director for serving in that capacity is not considered remuneration.</td>
</tr>
</tbody>
</table>
| 3 | In the context of deferred compensation:  
  - Remuneration is treated as paid on the date amounts are no longer subject to substantial risk of forfeiture (as defined under Section 457(f)).  
  - The amount of the remuneration is the present value of future payments as of the vesting date.  
  - *Previously paid remuneration:* Amounts that are treated as paid under Section 4960, but not actually or constructively paid until a future date. Net earnings on previously paid remuneration are treated as paid at the close of the calendar year of accrual.  
  - Present value of remuneration that was vested as of taxable year ending on or after December 31, 2017 is not subject to the excise tax, but earnings of this amount will be treated as remuneration for Section 4960 in subsequent years. |
**Section 4960 key terms**

<table>
<thead>
<tr>
<th>Applicable tax-exempt organization (ATEO)</th>
<th>Covered employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>• ATEOs are organizations that fall under any of the following categories:</td>
<td>• One of the <strong>five highest compensated employees</strong> of the ATEO for the taxable year</td>
</tr>
<tr>
<td>1) Exempt from tax under <strong>Section 501(a)</strong></td>
<td>• Any individual who was a <strong>covered employee for any preceding taxable year</strong> beginning after December 31, 2016</td>
</tr>
<tr>
<td>2) Farmer’s cooperative described in <strong>Section 521(b)(1)</strong></td>
<td></td>
</tr>
</tbody>
</table>
### Section 4960 key terms *(continued)*

| **Remuneration** | All “wages” as defined under Section 3401 (excluding designated Roth after-tax contributions) and non-qualified deferred compensation amounts when the amounts are no longer subject to a substantial risk of forfeiture (as defined under Section 457(f))  
Includes compensation paid with respect to employment of an employee by “any related person or governmental entity” |
| **Parachute payment** | A “parachute payment” is any compensatory payment to (or for the benefit of) a “covered employee” if (1) the payment is contingent on an employee’s involuntary separation from employment and (2) the present value of all such payments equals or exceeds three times the employee’s “base amount”  
Generally limited to severance and damages payments  
Payments made to an executive who resigns would generally not qualify  
The term “parachute payment” does not include any payment made:  
- Under a qualified plan as described in Section 280G(b)(6)  
- Under an annuity contract described in Section 403(b) or a plan described in Section 457(b)  
- To a licensed medical professional (including a veterinarian) to the extent such payment is for the performance of medical or veterinary services  
- To an individual who is not a “highly compensated employee” as defined in Section 414(q) |
Section 4960 key terms *(continued)*

**Base amount**
- The employee’s annualized compensation over the five-year period ending prior to the date of termination of employment

**Excess parachute payment**
- If the employee is entitled to a parachute payment, then the entire amount of the payment in excess of the base amount is considered an “excess parachute payment” that is subject to the excise tax.
# Reporting and payment of excise tax

<table>
<thead>
<tr>
<th><strong>Who</strong></th>
<th>Organizations subject to the Section 4960 tax on payments of more than $1M in remuneration or excess parachute payments paid in the <em>calendar year ending with or within the tax year of the exempt organization or related organization subject to the tax</em>.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What</strong></td>
<td>Each ATEO and related organization (including a related taxable organization) must file a separate <strong>Form 4720</strong> to report its share of the tax. The 2018 draft Form 990 includes a new question on Part V, Question 15, asking whether the organization filed a Form 4720.</td>
</tr>
<tr>
<td><strong>When</strong></td>
<td>Form 4720 must be filed by the <strong>15th day of the fifth month</strong> after the end of the organization’s taxable year (or, if the organization has not established a taxable year for Federal income tax purposes, the organization’s annual accounting period) during which the excise tax liability was incurred. Organizations can extend the Form 4720 filing deadline via the Form 8868, but must still make payments by the original due date.</td>
</tr>
</tbody>
</table>
Example 1 – Limited services exception

Assume a CEO of a hospital system splits her time between Parent Entity A (ATEO) and Hospital B (ATEO, related organization to A).

- She performs 95% of her services and receives 95% of her remuneration from A
- She performs 5% of her services and receives 5% of her remuneration from B

**Result:** The CEO is considered a covered employee of A, but not considered a covered employee of B.

**Note:** B is still considered the common-law employer of the CEO and would be required to file the Form 4720 and pay its allocable portion of the excise tax as a related organization to A.
Example 2 – Remuneration

Example – Dual employment

- Tax-exempt Hospital A (ATEO) controls related organization Lab Services Corporation B (taxable, for-profit)
- Lab Services Corporation B employs one of Hospital A’s covered employees

**Result:** Both Hospital A and Lab Services Corporation B can potentially be liable for the Section 4960 excise tax.

Example – Related organization

- Hospital System A has a consolidated management system that employs all executives who oversee the operations of the entire enterprise
- Hospital System B has a decentralized management system, meaning each lower-tier hospital employs its own CEO, CFO, and executives

**Result:** Hospital System A may be subject to an excise tax on no more than its five highest compensated executives. Hospital System B may be subject to a higher excise tax, given each lower-tier hospital may also be subject to an excise tax on its five most highly compensated employees.
**Example 3 – Excise tax**

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess remuneration threshold</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Excess remuneration</td>
<td>(a) - (b) $285,000</td>
</tr>
<tr>
<td>Excess remuneration excise tax</td>
<td>(c) x 21% $59,850</td>
</tr>
</tbody>
</table>

**Total excise tax:** $59,850

Exempt organizations should model and understand the amount of compensation that may be paid to their covered employees in any given year taking into account the entire life cycle of all compensatory arrangements.
## Example 4 – Excise tax

### Example – Covered employee experiences involuntary separation from employment

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base salary</td>
<td>$600,000</td>
</tr>
<tr>
<td>Other</td>
<td>$300,000</td>
</tr>
<tr>
<td>Deferred compensation vesting</td>
<td>$50,000</td>
</tr>
<tr>
<td>Accelerated vesting due to separation</td>
<td>$500,000</td>
</tr>
<tr>
<td>Severance payments</td>
<td>$2,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,450,000</strong></td>
</tr>
</tbody>
</table>

**Potential parachute payments**

### Excise tax computation

<table>
<thead>
<tr>
<th>Description</th>
<th>Excess parachute payment</th>
<th>Excess remuneration</th>
</tr>
</thead>
<tbody>
<tr>
<td>4960 base amount</td>
<td>$750,000</td>
<td></td>
</tr>
<tr>
<td>3x base amount threshold</td>
<td>$2,249,999</td>
<td></td>
</tr>
<tr>
<td>Amount over / (under) threshold</td>
<td>$250,001</td>
<td></td>
</tr>
<tr>
<td>“Excess parachute” amount</td>
<td>$1,750,000 (b)</td>
<td></td>
</tr>
<tr>
<td>Total remuneration less “excess parachute”</td>
<td></td>
<td>$1,700,000 (c) = (a) - (b)</td>
</tr>
<tr>
<td>Excess remuneration</td>
<td></td>
<td>$700,000</td>
</tr>
<tr>
<td>Excise tax amount</td>
<td>$367,500</td>
<td>$147,000</td>
</tr>
</tbody>
</table>

**Total excise tax:**

$514,500
### Example 5 – Excise tax

**Example – Covered employee experiences involuntary separation from employment**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base salary</td>
<td>$500,000</td>
</tr>
<tr>
<td>Other</td>
<td>$150,000</td>
</tr>
<tr>
<td>Deferred compensation vesting</td>
<td>$35,000</td>
</tr>
<tr>
<td>Accelerated vesting due to separation</td>
<td>$200,000</td>
</tr>
<tr>
<td>Severance payments</td>
<td>$1,200,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,085,000</strong></td>
</tr>
</tbody>
</table>

| Potential parachute payments                     | **$200,000** |
| Total remuneration less “excess parachute”       | **$1,200,000** |

**Excise tax computation**

<table>
<thead>
<tr>
<th>Description</th>
<th>Excess parachute payment</th>
<th>Excess remuneration</th>
</tr>
</thead>
<tbody>
<tr>
<td>4960 base amount</td>
<td>$550,000</td>
<td></td>
</tr>
<tr>
<td>3x base amount threshold</td>
<td>$1,649,999</td>
<td></td>
</tr>
<tr>
<td>Amount over / (under) threshold</td>
<td>($249,999)</td>
<td></td>
</tr>
<tr>
<td>“Excess parachute” amount</td>
<td>$0(b)</td>
<td>$2,085,000</td>
</tr>
<tr>
<td>Total remuneration less “excess parachute”</td>
<td></td>
<td><strong>$1,085,000</strong></td>
</tr>
<tr>
<td>Excess remuneration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excise tax amount</td>
<td></td>
<td><strong>$227,850</strong></td>
</tr>
</tbody>
</table>

**Total excise tax:** **$227,850**
# Example 6 – Excise tax

## Example – Covered employee experiences involuntary separation from employment

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Base salary</td>
<td>$150,000</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>$75,000</td>
<td></td>
</tr>
<tr>
<td>Deferred compensation vesting</td>
<td>$45,000</td>
<td></td>
</tr>
<tr>
<td>Accelerated vesting due to separation</td>
<td>$150,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>Severance payments</td>
<td>$600,000</td>
<td>$600,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,020,000(a)</td>
<td>$750,000</td>
</tr>
</tbody>
</table>

### Excise tax computation

<table>
<thead>
<tr>
<th></th>
<th>Excess parachute payment</th>
<th>Excess remuneration</th>
</tr>
</thead>
<tbody>
<tr>
<td>4960 base amount</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>3x base amount threshold</td>
<td>$599,999</td>
<td></td>
</tr>
<tr>
<td>Amount over / (under) threshold</td>
<td>$150,001</td>
<td></td>
</tr>
<tr>
<td>“Excess parachute” amount</td>
<td>$550,000(b)</td>
<td>$470,000 (c) = (a) - (b)</td>
</tr>
<tr>
<td>Total remuneration less “excess parachute”</td>
<td>$470,000 (c) = (a) - (b)</td>
<td>$0</td>
</tr>
<tr>
<td>Excess remuneration</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Excise tax amount</td>
<td>$115,500</td>
<td>$0</td>
</tr>
</tbody>
</table>

**Total excise tax:** $115,500
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