

## Interim Guidance Under Section 4960

Notice 2019-09

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## I. PURPOSE AND OVERVIEW

This notice provides interim guidance regarding section 4960 of the Internal Revenue Code (Code), enacted on December 22, 2017, pursuant to section 13602 of Tax Cuts and Jobs Act, Pub. L. No. 115-97 (the Act). Section 4960(a) imposes an excise tax equal to the rate of tax under section 11 (currently 21 percent) on the amount of remuneration in excess of \$1 million and any excess parachute payment paid by an applicable tax-exempt organization to a covered employee.

The interim guidance is intended to assist taxpayers in applying section 4960 while the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) develop further guidance on the application of section 4960, and addresses certain issues under section 4960 on which stakeholders have indicated that they would benefit from interim guidance. Specifically, the Treasury Department and the IRS intend to issue proposed regulations on the amendments made by section 13602 of the Act that will incorporate the guidance provided in this notice. However, as provided in Section IV of this notice, any future guidance under section 4960 will be prospective and will not apply to taxable years beginning before the issuance of that guidance. Until further guidance is issued, to comply with the requirements of section 4960, taxpayers may base their positions upon a good faith, reasonable interpretation of the statute, including consideration of the legislative history, if appropriate. The positions reflected in this notice constitute a good faith, reasonable interpretation of the statute. Whether a taxpayer's position that is inconsistent with this notice constitutes a good faith, reasonable interpretation of the statute generally will be determined based upon all of the relevant facts and circumstances, including whether

the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved interpretive issues based on consistent principles and in a consistent manner. Notwithstanding the previous sentence, this preamble describes certain positions that the Treasury Department and the IRS have concluded are not consistent with a good faith, reasonable interpretation of the statutory language. The Treasury Department and the IRS intend to embody these positions as part of the forthcoming proposed regulations.

Comments are requested on all aspects of this notice. See Section III of this notice regarding requests for comments on specific aspects of this notice and for information on how to submit comments.

**A. Section 4960 — In General**

Section 4960(a) of the Code generally provides that an applicable tax-exempt organization (ATEO), or a related organization, that pays remuneration in excess of \$1 million or any excess parachute payment to a covered employee is subject to an excise tax on the amount of the excess remuneration and excess parachute payments at a rate equal to the rate of tax imposed on corporations under section 11 (currently 21 percent).

Section 4960(a)(1) refers to remuneration paid “for the taxable year,” but does not specify which taxpayer’s taxable year is used, what it means for remuneration to be paid “for” a taxable year, or how to measure remuneration if an ATEO and a related organization have different taxable years. Q/A–2 provides that the excise tax imposed on excess remuneration and excess parachute payments is determined based on remuneration paid and excess parachute payments made in the calendar year ending

with or within the taxable year of the employer. This measurement period, as commenters suggested, will reduce the administrative burdens that would arise if taxpayers were required to allocate remuneration paid during a single calendar year to multiple non-calendar taxable years. Moreover, this approach will reduce administrative burdens by aligning more closely with the calendar year reporting of compensation on Form W-2, Wage and Tax Statement, and Form 990, Return of Organization Exempt From Income Tax.

Some commenters recommended that ATEOs and related organizations be allowed, but not required, to treat remuneration paid during the calendar year ending with or within the taxable year of the employer as remuneration paid “for the taxable year” under section 4960(a)(1). Commenters recommended this rule be elective in order for non-calendar year taxpayers to avoid the potential inclusion of remuneration for a period prior to the effective date of section 4960 (the first taxable year beginning after December 31, 2017). Q/A–13 and Q/A–39 avoid that result by treating remuneration in which the covered employee vested before the effective date of section 4960 as paid before that effective date. Because these Q/As address the issue raised by the commenters, the Treasury Department and the IRS have concluded that an election for the remuneration measurement period is unnecessary.

The guidance in this notice provides rules regarding the entity that is liable for the excise tax under section 4960, and how that excise tax is calculated. Q/A–3 provides that the common-law employer, as determined generally for federal tax purposes, is liable for the excise tax imposed under section 4960. A common-law employer may not avoid treating a payment as remuneration under section 4960 by reason of a third party

payor arrangement. A payment to the employer's employee from a third party payor (including a payroll agent, common paymaster, statutory employer under section 3401(d)(1), or certified professional employer organization) or from an unrelated management company, is considered a payment to the employee from the common-law employer. Similarly, a payment to the employee from a related entity, including a related entity that is an ATEO, for services rendered to the common-law employer, is considered a payment to the employee from the common-law employer for purposes of calculating remuneration and determining liability for the excise tax. Q/A–3 also clarifies that calculation of the excise tax is separate from any arrangement that an ATEO and any related organization may have for bearing the cost of the excise tax under section 4960.

One commenter requested guidance providing that remuneration paid by a separate employer that is a related for-profit or governmental entity (other than an ATEO) is taken into account in determining whether a covered employee has remuneration in excess of \$1 million, but that the related entity is not liable for its share of the excise tax under section 4960. There is no statutory support for creating such an exception for for-profit and governmental entities. Section 4960(c)(4)(B), which defines related organizations, applies to any "person or governmental entity" that meets any of the relationship tests in section 4960(c)(4)(B)(i)-(v). Unlike the definition of an ATEO under section 4960(c)(1)(C), which applies only to a governmental entity that excludes

income from taxation under section 115(1),<sup>1</sup> section 4960(c)(4)(B) applies to any “governmental entity” that is related to an ATEO. Similarly, a for-profit entity is a “person” under generally applicable tax principles. In addition, excepting for-profit entities from liability as related organizations would be inconsistent with section 4960(c)(6), which coordinates the tax on excess parachute payments with the section 162(m) deduction limitation (which only applies to for-profit entities). Further, section 4960(c)(4)(C), which describes the liability for the excise tax, refers to any case in which remuneration from more than one employer is taken into account, stating that “each such employer” shall be liable, without qualification as to the employer’s status as an ATEO. For these reasons, the Treasury Department and the IRS have concluded that the position that a for-profit or governmental entity that is a related organization with regard to an ATEO is not liable for its share of the excise tax under section 4960 is not consistent with a good faith, reasonable interpretation of the statute.

Some ATEOs will not be impacted by section 4960 because they do not pay an employee enough remuneration to trigger the tax. There can be no excess remuneration under section 4960(a)(1) if an ATEO (together with any related organization) pays remuneration of less than \$1 million to each of its employees for a

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<sup>1</sup> Section 4960(c)(1)(C) refers to an entity that “has income excluded from taxation under section 115(1).” However, section 115(1) refers to income that is excluded from gross income. For consistency with the language in section 115(1), this notice refers to an entity that “has income excluded from gross income under section 115(1),” except where directly quoting section 4960(c)(1)(C).

taxable year, and there can be no excess parachute payment under section 4960(a)(2) if the employer does not have any “highly compensated employees” under section 414(q)<sup>2</sup> for the taxable year. In that case, no excise tax under section 4960 is owed. For example, an ATEO that does not pay compensation (within the meaning of section 414(q)) of \$125,000 or more to any employee in 2018 and 2019 is not subject to excise tax under section 4960 for 2019.

However, there is no minimum dollar threshold for an employee to be a covered employee. Even if an ATEO has no liability under section 4960 for one year, the ATEO may later need to determine its five highest-compensated employees for that taxable year, as those employees continue be covered employees in all future years and may be paid excess remuneration or excess parachute payments in a future year.

#### **B. Applicable Tax-Exempt Organizations and Related Organizations**

Section 4960(c)(1) provides that an “applicable tax-exempt organization” is any organization that for the taxable year—(A) is exempt from taxation under section 501(a), (B) is a farmers’ cooperative organization described in section 521(b)(1), (C) has income excluded from taxation under section 115(1), or (D) is a political organization described in section 527(e)(1).

One commenter requested clarification on the application of section 4960 to governmental entities. Q/A–5 clarifies that certain governmental entities are not ATEOs within the meaning of section 4960(c)(1). A governmental entity (including a state

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<sup>2</sup> The limitation used in the definition of highly compensated employee under section 414(q)(1)(B) is adjusted for inflation. For 2019, the limitation is \$125,000. Notice 2018-83, 2018-47 I.R.B. 774.

college or university) that is not recognized as exempt from taxation under section 501(a) and does not exclude income from gross income under section 115(1) is not an ATEO described in section 4960(c)(1). Conversely, a governmental entity that excludes income from gross income under section 115(1) (even if the entity has other income that is not excluded from gross income under section 115(1)), or is recognized as exempt from taxation under section 501(a), is an ATEO described in section 4960(c)(1).

Q/A–6 clarifies that a governmental entity that sought and received a determination letter recognizing its tax-exempt status under section 501(c)(3) may relinquish this status pursuant to the procedures described in section 3.01(12) of Rev. Proc. 2018-5, 2018-1 I.R.B. 233, 239. However, an entity that excludes income from gross income under section 115(1) is an ATEO regardless of whether it has a private letter ruling to that effect.

Section 4960(c)(4)(A) provides that remuneration paid to a covered employee by an ATEO includes any remuneration paid with respect to employment of the employee by any related person or governmental entity. The Treasury Department and the IRS interpret the phrase “any related person or governmental entity” to include not only related ATEOs but also related taxable organizations and related governmental units or other governmental entities. Section 4960(c)(4)(B) provides that a person or governmental entity is related to an ATEO if such person or governmental entity—

- (i) controls, or is controlled by, the organization;
- (ii) is controlled by one or more persons which control the organization;
- (iii) is a supported organization (as defined in section 509(f)(3)) during the taxable year with respect to the organization;
- (iv) is a

supporting organization described in section 509(a)(3) during the taxable year with respect to the organization; or (v) in the case of an organization which is a voluntary employees' beneficiary association described in section 501(c)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.

For purposes of defining "control" within the meaning of section 4960(c)(4)(B)(i)-(ii), Q/A-8 provides rules based on the definition of control under section 512(b)(13)(D). Thus, the definition of related organization for purposes of section 4960 generally aligns with the definition of related organization for purposes of the annual reporting requirements on Form 990, reducing the burden on organizations in identifying related organizations, calculating compensation from related organizations, and determining liability under section 4960.

Q/A-8 does not adopt the test for control under section 414(b) and (c), which generally uses the same test for control of a nonprofit organization as section 512(b)(13)(D) except that it replaces the 50 percent threshold with an 80 percent threshold. Instead, Q/A-8 adopts the control test under section 512(b)(13)(D) for the administrative convenience of taxpayers, to align more closely with other exempt organization control tests, and to prevent abuse that may occur in the section 4960 context under the higher 80 percent control threshold that was established for qualified plans.

### **C. Covered Employees**

Section 4960(c)(2) defines a covered employee as any employee who is one of an ATEO's five highest-compensated employees for the current taxable year or who was a covered employee of the ATEO (or any predecessor) for any preceding taxable

year beginning after December 31, 2016. Therefore, once an employee is a covered employee, he or she continues to be a covered employee for all subsequent taxable years. There is no minimum dollar threshold for an employee to be a covered employee; thus, an employee need not be paid excess remuneration or an excess parachute payment nor be a highly compensated employee within the meaning of section 414(q) to be a covered employee for a taxable year and all future years.

Commenters requested that the Treasury Department and the IRS provide a rule of administrative convenience under which a covered employee is no longer considered a covered employee of an ATEO after a certain period of time. The guidance in this notice does not adopt that suggestion because it is inconsistent with the statute. For this reason, the Treasury Department and the IRS have concluded that the position that a covered employee ceases to be a covered employee after a certain period of time is not consistent with a good faith, reasonable interpretation of the statute.

Section 4960 does not provide rules for identifying an ATEO's five highest-compensated employees for a taxable year. Q/A-10 provides that whether an employee is one of an ATEO's five highest-compensated employees is based on remuneration paid in the calendar year ending with or within the employer's taxable year. The Treasury Department and the IRS considered using certain existing reporting standards for determining the amount of compensation paid, such as the Securities and Exchange Commission standards that are used for section 162(m) purposes or the standards that are used for Form 990 reporting purposes. However, Q/A-10 uses remuneration paid for purposes of identifying an ATEO's five highest-compensated employee because, as defined in Q/A-12, remuneration is a fair representation of

compensation earned by an employee and it is more administrable to use a single standard for both identifying covered employees and computing the tax, if any, imposed by section 4960(a)(1). In addition, having the calendar year ending with or within the ATEO's or related organization's taxable year as the measurement period for identifying the ATEO's five highest-compensated employees is consistent with the measurement period for purposes of determining remuneration paid for a taxable year.

Q/A-10 provides that remuneration paid for medical services is not taken into account for purposes of identifying the five highest-compensated employees. One commenter requested that remuneration paid for medical services be taken into account for purposes of determining the five highest-compensated employees. An interpretation that remuneration for medical services is taken into account for purposes of identifying the five-highest compensated employees would be inconsistent with the statutory structure and the legislative intent, and therefore the Treasury Department and the IRS have concluded that this interpretation is not consistent with a good faith, reasonable interpretation of section 4960. As the Conference Report to accompany H.R. 1 (Conference Report) states, “[f]or purposes of determining a covered employee, remuneration paid to a licensed medical professional which is directly related to the performance of medical or veterinary services by such professional is not taken into account, whereas remuneration paid to such a professional in any other capacity is taken into account.” H.R. Rep. No. 115-466, at 494 (2017) (Conf. Rep.).

As set forth in Q/A–9, only an ATEO's common law employees (including officers) can be one of an ATEO's five highest-compensated employees. To identify its five highest-compensated employees, the ATEO must include remuneration paid for the

taxable year by any related organization, including remuneration paid by a related for-profit organization or governmental entity, for services performed as an employee of such related organization. Q/A–12(c) also provides that remuneration paid by a separate organization on behalf of the ATEO, whether related to the ATEO or not, for services performed as an employee of the ATEO is treated as remuneration paid by the ATEO for purposes of section 4960. To prevent circumstances in which an employee to whom the ATEO paid minimal remuneration displaces an employee who would otherwise be a covered employee of the ATEO, Q/A–10(b) provides a limited services exception under which, unless an ATEO pays at least 10 percent of the total remuneration paid by the ATEO and all related organizations to an employee during the calendar year, the employee is not treated as one of the ATEO’s five highest-compensated employees. However, if no ATEO pays at least 10 percent of an employee’s total remuneration during a calendar year, this exception does not apply to the ATEO that paid the most remuneration to the employee during the calendar year.

Whether an employee is one of the five highest-compensated employees is determined separately for each ATEO, and not for the entire group of related organizations; thus, each ATEO has its five highest-compensated employees. As a result, in many cases, a group of related organizations will have more than five covered employees. Some commenters suggested that a group of related ATEOs should have only five highest-compensated employees among all of the related ATEOs, noting that this is the case for purposes of section 162(m)(1)-(4), as Treas. Reg. § 1.162-27(c)(1)(ii) treats a publicly held corporation and all nonpublic corporations related to the publicly held corporation as a single corporation. Section 4960 does not provide for such

treatment. Further, under Treas. Reg. § 1.162-27(c)(1)(ii), each related subsidiary within an affiliated group of corporations that is itself a publicly held corporation is separately subject to the deduction limitation, just as each ATEO within a group of related organizations is separately subject to section 4960. Accordingly, this notice does not adopt the commenter's suggestion, and the Treasury Department and the IRS have concluded that the position that a group of related organizations with more than one ATEO has a single set of five highest-compensated employees is not consistent with a good faith, reasonable interpretation of section 4960.

#### **D. Excess Remuneration**

In general, the excise tax imposed under section 4960(a)(1) is based on the remuneration paid (other than any excess parachute payment) by an ATEO for the taxable year with respect to employment of any covered employee in excess of \$1 million. Q/A–11 provides that this amount is referred to as “excess remuneration.” Consistent with the statute, the \$1 million threshold is not adjusted for inflation.

Section 4960(c)(3)(A) generally defines “remuneration” as wages under section 3401(a) (wages subject to federal income tax withholding), but excluding designated Roth contributions under section 402A(c) and including amounts required to be included in gross income under section 457(f). Q/A–12 clarifies that remuneration includes a parachute payment that is not an excess parachute payment, but remuneration does not include certain retirement benefits (see section 3401(a)(12)) or certain directors' fees (see Rev. Rul. 57-246, 1957-1 C.B. 338).

The flush language at the end of section 4960(a) provides that, for purposes of section 4960(a), remuneration is treated as paid when there is no substantial risk of

forfeiture of the rights to the remuneration. The term “substantial risk of forfeiture” is defined by cross-reference to section 457(f)(3)(B). Proposed regulations under section 457(f) were published in 2016 (81 FR 40548 (Jun. 22, 2016)). The preamble to the proposed regulations states that taxpayers may rely on them before they are finalized. Q/A–13 provides that the definition of substantial risk of forfeiture under Prop. Treas. Reg. § 1.457-12(e)(1) is the definition of substantial risk of forfeiture within the meaning of section 457(f)(3)(B) for purposes of section 4960(a).<sup>3</sup> Under Prop. Treas. Reg. § 1.457-12(e)(1), an amount of compensation is subject to a substantial risk of forfeiture only if entitlement to the amount is conditioned on the future performance of substantial services, or upon the occurrence of a condition that is related to a purpose of the compensation if the possibility of forfeiture is substantial. Consistent with common usage, Q/A–13 refers to an amount the right to which is not subject to a substantial risk of forfeiture as being “vested” and the lapsing of a substantial risk of forfeiture as “vesting.”

Q/A–13 clarifies that although section 4960(a) cross-references the definition of substantial risk of forfeiture in section 457(f)(3)(B), the rule under section 4960(a) providing that remuneration is treated as paid upon vesting is not limited to remuneration that is otherwise subject to section 457(f), nor is it limited to nonqualified deferred compensation under section 457(f) or section 409A. Rather, this timing rule for determining when remuneration is treated as paid applies to all forms of remuneration.

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<sup>3</sup> Any changes to the proposed regulations under section 457(f) when finalized will be taken into account for purposes of section 4960, and further guidance may be issued if appropriate.

Some commenters argued that section 4960(c)(3), which defines remuneration largely by cross-reference to the definition of wages under section 3401(a), should be interpreted as a timing rule. Section 3401(a) primarily focuses on whether, not when, amounts are includible in wages; the basic timing rule for wage inclusion appears in regulations under section 3402(a), not section 3401(a). Specifically, Treas. Reg. § 31.3402(a)-1(b) provides that wages are paid when actually or constructively paid and explains what it means for an amount to be constructively paid. Thus, the Treasury Department and the IRS conclude that the cross-reference to section 3401(a) (and not section 3402(a)) in section 4960(c)(3) establishes the scope of the term “remuneration” without regard to timing, and that the flush language in section 4960(a) establishes the timing rule that applies to all forms of remuneration. Accordingly, Q/A–13 provides that, for purposes of determining when remuneration is treated as paid, the timing rule in section 4960(a) applies and the timing rule for wage inclusion under Treas. Reg. § 31.3402(a)-1(b) is not relevant.

Under Q/A–13, the amount of remuneration treated as paid at vesting is the present value of the remuneration in which the covered employee vests. The employer must determine the present value using reasonable actuarial assumptions regarding the time and likelihood of actual or constructive payment. The employer may use the rules set forth in Prop. Treas. Reg. § 1.457-12(c)(1) to determine the present value. In addition, for purposes of determining the present value of remuneration that is scheduled to be paid within 90 days of vesting, the employer may elect to treat the amount that is to be paid as the present value of the amount on the date of vesting.

Until actually or constructively paid, the amount treated as paid at vesting is referred to as “previously paid remuneration.”

Q/A–13 provides specific rules for timing of inclusion for earnings and losses on previously paid remuneration. Net earnings on previously paid remuneration are treated as paid at the close of the calendar year in which they accrue. For example, the present value of vested remuneration credited to an employee’s account under an account balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(A) (under which the earnings and losses attributed to the account are based solely on a predetermined actual investment or a reasonable market interest rate) is treated as paid on the date credited to the employee’s account and, until subsequently actually or constructively paid, is treated as previously paid remuneration. However, at the close of each calendar year in which there is previously paid remuneration allocable to a covered employee, the present value of any net earnings accrued on that previously paid remuneration (the increase in present value due to the predetermined actual investment or a reasonable market interest rate) is treated as remuneration paid (and subsequently is treated as previously paid remuneration until actually or constructively paid). Similarly, the present value of a vested, fixed amount of remuneration under a nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) is treated as paid on the date of vesting and subsequently as previously paid remuneration until actually or constructively paid. But, at the close of each calendar year in which there is previously paid remuneration allocable to a covered employee, the net increase in the present value of that amount during the year constitutes earnings and is treated as remuneration paid (and subsequently is also treated as previously paid remuneration

until actually or constructively paid). For this purpose, earnings and losses from one arrangement may be aggregated with earnings and losses from any other arrangement provided by the same employer in which the employee participates, resulting in a single amount of remuneration and one amount, if any, of carryover losses (but no carryover gains, since any net gain would be treated as remuneration for the taxable year). For purposes of determining earnings and losses, previously paid remuneration is reduced by the amount actually or constructively paid under the plan or arrangement granting the rights to such remuneration. Q/A–13 further illustrates the operation of these rules through examples.

One commenter requested a “grandfather” rule like the transition rule under section 13601 of the Act that amended section 162(m). Because section 13602 of the Act, which added section 4960 to the Code, does not provide a transition rule (in contrast to section 13601 of the Act), and there is no indication in the legislative history that Congress intended there to be a transition rule for section 4960, the Treasury Department and the IRS have concluded that it is inappropriate to provide an effective date exception similar to the one provided for purposes of section 13601 of the Act. However, Q/A–13 clarifies and demonstrates the grandfathering effect of the remuneration payment timing rule. Specifically, Q/A–13 clarifies that any vested remuneration, including vested but unpaid earnings on deferred amounts, that is treated as paid before section 4960 is applicable (January 1, 2018, in the case of a calendar year employer) is not subject to the excise tax imposed under section 4960(a)(1), although earnings after the effective date on those amounts are treated as remuneration paid for purposes of section 4960(a)(1). Similarly, Q/A–13 clarifies that vested amounts

that would have been treated as remuneration paid (including vested but unpaid earnings) before the year in which an employee first becomes a covered employee are not remuneration for the first year the employee becomes a covered employee or any subsequent year and, therefore, are not subject to the excise tax imposed under section 4960(a)(1). However, subsequent earnings on that vested remuneration may be subject to excise tax under section 4960(a)(1).

To reduce administrative burdens, some commenters recommended that remuneration be determined solely by reference to the amount reportable in Form W-2, box 1. For the following reasons, the Treasury Department and the IRS have concluded it is inappropriate to adopt that recommendation. In defining remuneration, section 4960(c)(3) explicitly cross-references and modifies the definition of wages under section 3401(a). Although the amount reportable in Form W-2, box 1 includes wages as defined under section 3401(a), it may also include amounts that are includible in the employee's gross income but are not wages under section 3401(a). In addition, as explained previously, the timing rule for when remuneration is paid under section 4960(a) differs from the timing rule for when wages are paid under section 3401(a). Therefore, the amount reported in Form W-2, box 1 in many cases will not be the same as the employee's remuneration for purposes of section 4960.

As an alternative to using the amount reported in Form W-2, box 1, some commenters recommended that remuneration be defined solely by reference to the amount reportable in Form W-2, box 5, which reports the amount of wages (as defined in section 3121(a)) subject to the Hospital Insurance tax under sections 3101(b) and 3111(b). However, there are differences between the definitions of wages under

sections 3401(a) and 3121(a), and there is no indication in the statute or legislative history that Congress intended that the definition of wages in section 3121(a) be used to determine remuneration under section 4960(a). In addition, the payment timing differences discussed previously apply so that the amounts reported in Form W-2, box 5 may not accurately reflect the remuneration paid for the applicable period for purposes of section 4960. For these reasons, the Treasury Department and the IRS have concluded it is not appropriate to adopt this recommendation.

An individual may perform services as a common-law employee for two different related organizations during the calendar year, one or both of which is an ATEO, in which case remuneration paid for the taxable year is aggregated for purposes of determining whether excess remuneration has been paid. To address these cases, Q/A–14 provides rules for allocating liability for the excise tax among the employers. As provided in section 4960(c)(4)(C), in any case in which an ATEO includes remuneration from one or more related organizations as separate employers of the individual in determining the excise tax imposed by section 4960(a), each employer is liable for its proportionate share of the excise tax.

The guidance in this notice provides specific instructions for calculating the excise tax on excess remuneration under section 4960(a)(1), including rules for allocating the excise tax among related employers and rules regarding a change in related status during the calendar year. As described further in Q/A–14, an employee may be a covered employee of more than one ATEO and each ATEO employer calculates its liability under section 4960(a)(1) taking into account the organizations to which it is related. In that case, Q/A–14 provides that, rather than owing tax as both an

ATEO and a related organization for the same remuneration paid to a covered employee, an employer is liable only for the greater of the excise tax it would owe as an ATEO or the excise tax it would owe as a related organization with respect to that covered employee.

#### **E. Medical and Veterinary Services**

Section 4960(c)(3)(B) and (c)(5)(C)(iii) exclude from remuneration and parachute payments, respectively, the portion of any compensation that is for the performance of medical or veterinary services by a licensed medical professional (including a veterinarian). The Conference Report states that “[f]or purposes of determining a covered employee, remuneration paid to a licensed medical professional which is directly related to the performance of medical or veterinary services by such professional is not taken into account, whereas remuneration paid to such a professional in any other capacity is taken into account.” Conf. Rep. at 494 (emphasis added).

Sections 4960(c)(3)(B) and (c)(5)(C)(iii) both use the phrase “medical or veterinary services.” Consistent with the legislative history quoted previously, Q/A–15 provides that remuneration for the direct performance of medical or veterinary services is excluded for purposes of section 4960. Commenters requested guidance as to the meaning of “licensed medical professional,” which is not defined in the statute. The Conference Report states that “[a] medical professional for this purpose includes a doctor, nurse, or veterinarian.” Conf. Rep. at 494. Q/A–15 provides that a licensed medical professional is an individual who is licensed under state or local law to perform medical or veterinary services. In addition to those professionals listed, this generally

includes dentists and nurse practitioners and may include other medical professionals depending on state or local law.

Commenters also requested guidance on the definition of medical services for purposes of section 4960. Q/A–15 adopts the definition of medical care under section 213(d) for purposes of determining whether services are medical services. This standard is consistent with the legislative intent that the exception apply only to remuneration for the direct performance of medical services and is a familiar standard for taxpayers. Section 213(d) provides that medical care consists of 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. For a veterinarian or other licensed veterinary professional, section 213(d)(1)(A) applies by analogy to determine whether the activity constitutes veterinary services.

In addition, commenters requested guidance on whether activities related to medical services, such as administrative, teaching, and research services, are medical services. Q/A–15 provides that these activities generally are not medical services. However, to the extent a licensed medical professional provides direct medical care to a patient in the course of these activities, he or she performs medical services, and remuneration allocable to those services is not taken into account for purposes of section 4960.

When a covered employee is compensated for both medical services and other services, the employer must allocate remuneration paid to such employee between medical services and such other services. Q/A–15 permits taxpayers to use any reasonable, good faith method to allocate remuneration between medical services and

other services. For this purpose, taxpayers may rely on a reasonable allocation set forth in an employment agreement that explicitly allocates a portion of the remuneration as for medical services or other services. If some or all of the remuneration is not reasonably allocated in an employment agreement, taxpayers must use a reasonable method of allocation. As an example of a reasonable method, a taxpayer may use records such as patient, insurance, and Medicare/Medicaid billing records or internal time reporting mechanisms to determine the time spent providing medical services, and then allocate remuneration to medical services in the proportion such time bears to the total hours the covered employee worked for the employer. The same rules apply with respect to veterinary services.

#### **F. Excess Parachute Payments**

Section 4960(a)(2) imposes an excise tax on “any excess parachute payment.” Section 4960(c)(5)(A) provides that the term “excess parachute payment” means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment. Section 4960(c)(5)(B) provides that the term “parachute payment” means any payment in the nature of compensation to (or for the benefit of) a covered employee if (i) such payment is contingent on such employee’s separation from employment with the employer, and (ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such separation equals or exceeds an amount equal to three times the base amount. Section 4960(c)(5)(C) provides exceptions for certain

retirement plans, certain payments to licensed medical professionals, and payments to individuals who are not highly compensated employees as defined in section 414(q).<sup>4</sup>

The excess parachute payment rules under section 4960 are modeled after section 280G. Section 280G disallows a deduction for any excess parachute payment. Although sections 280G and 4960 both use the term “parachute payment,” they define it differently. Whereas the section 4960 definition refers to payments contingent on an employee’s separation from employment, the section 280G definition refers to payments contingent on a change in the ownership or effective control of a corporation (or in the ownership of a substantial portion of the assets of the corporation). There are also other differences between sections 280G and 4960. For example, section 280G does not include exceptions for payments to licensed medical professionals or non-highly compensated employees. The guidance in this notice incorporates many of the questions and answers (Q/As) under Treas. Reg. § 1.280G-1, with modifications to reflect the statutory differences between sections 280G and 4960. However, certain Q/As under Treas. Reg. § 1.280G-1 are not incorporated into this notice because they address issues that do not arise under section 4960. Conversely, certain Q/As in this notice do not have parallel Q/As under Treas. Reg. § 1.280G-1 because they address issues that arise under section 4960 but not under section 280G.

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<sup>4</sup> Under section 414(q), a highly compensated employee generally is defined as any employee who was a five-percent owner at any time during the year or the preceding year or who had compensation from the employer in the preceding year in excess of an inflation-adjusted amount. Notice 2017-64, 2017-45 I.R.B. 486, and Notice 2018-83, provide that the inflation-adjusted amounts for 2018 and 2019 are \$120,000 and \$125,000, respectively. See section 414(q) and the regulations thereunder for additional details, including the availability of an election to treat no more than the top 20 percent of an employer’s employees as highly compensated employees by reason of their compensation.

The discussion of Q/A–16 through Q/A–34 that follows provides an overview of the guidance in this notice for purposes of calculating the excise tax under section 4960(a)(2), noting certain similarities and differences between those Q/As and the Q/As under Treas. Reg. § 1.280G-1. As a preliminary matter, however, the following summarizes the basic steps used to determine the amount of excise tax (if any) under section 4960(a)(2):

Step 1: Determine if a covered employee is entitled to receive payments in the nature of compensation that are contingent on an involuntary separation from employment and are not subject to an exclusion.

Step 2: Calculate the total aggregate present value of the contingent payments, taking into account the special valuation rules that apply when an involuntary separation from employment accelerates payment or vesting of a right to a payment.

Step 3: Calculate the covered employee's base amount with respect to the base period.

Step 4: Determine if the contingent payments are parachute payments. The contingent payments are parachute payments if their total aggregate present value equals or exceeds an amount equal to three times the covered employee's base amount.

Step 5: Calculate the amount of excess parachute payments. A parachute payment is an excess parachute payment to the extent the payment exceeds the base amount allocated to the payment. (Note that this is the excess over 1 times the base amount, and not the excess over 3 times the base amount.)

Step 6: Calculate the amount of excise tax under section 4960(a)(2). The excise tax is the amount equal to the product of the rate of tax under section 11 and the sum of any excess parachute payments paid by an ATEO or related organization to the covered employee.

Q/A–16 defines the term “excess parachute payment,” and Q/A–17 defines the term “parachute payment.” Q/A–18, which defines a “payment in the nature of compensation,” is based on Treas. Reg. § 1.280G-1, Q/A–11. Q/A–19, which describes when a payment is considered made for purposes of section 4960(a)(2), including the treatment of section 83 property, stock options, and stock appreciation rights and the treatment of consideration paid by an employee, is based on Treas. Reg. § 1.280G-1, Q/A–12 through Q/A–14.

Q/A–20 describes when a payment is contingent on an employee’s separation from employment. Commenters requested that the Treasury Department and the IRS clarify what it means for a payment to be contingent on a separation from employment, noting that the statute does not provide a definition. One commenter suggested that the Treasury Department and the IRS issue guidance treating a payment as contingent on an employee’s separation from employment only if the payment is subject to a substantial risk of forfeiture (defined in a manner consistent with section 457(f) or section 409A) at the time of a separation from employment and the separation causes the risk of forfeiture to lapse. The guidance in this notice is generally consistent with that suggestion, with certain exceptions discussed in the next several paragraphs.

Separation from employment (whether voluntary or involuntary) is often used in compensation arrangements as the trigger to pay vested amounts. For example, it is

typical for a nonqualified deferred compensation plan to provide that payments will be made or begin upon a separation from employment, including separation from employment resulting from death or disability. In contrast, Treas. Reg. § 1.280G-1, Q/A–22 generally treats a payment as contingent on a change in ownership or control if the payment would not have been made had no change in ownership or control occurred, taking into consideration whether vesting or payment is accelerated by reason of the change in ownership or control. Similarly, in defining when a payment is contingent on separation from employment, this notice does not focus solely on whether the payment would not have been made but for a separation from employment, but instead also takes into consideration whether the separation from employment results in the employee becoming vested or otherwise accelerates the right to payment.

The guidance in this notice limits the payments treated as contingent on a separation from employment to payments contingent on an involuntary separation from employment because payments that vest upon a separation from employment typically vest only upon an involuntary separation from employment. If an employee may voluntarily separate from service and still be entitled to a payment, then the payment either is not subject to a substantial risk of forfeiture or the forfeiture condition is not related to the separation from employment. If, however, there are other types of separation from employment conditions that may result in the lapse of a substantial risk of forfeiture applicable to a payment, the standard in this notice may be expanded in future guidance to ensure that those payments are also treated as contingent on a separation from employment.

Specifically, Q/A–20 provides that a payment is contingent on a separation from employment if the payment would not have been made in the absence of an involuntary separation from employment. It further provides that if the right to a payment vests as a result of an involuntary separation from employment, the payment is treated as a payment that is contingent on a separation from employment. For example, a right to a severance payment provided in an employment agreement that vests upon an involuntary separation from employment is a payment contingent on a separation from employment.

However, not all payments that are made after an involuntary separation from employment are contingent on a separation from employment. For example, a payment of deferred compensation after an involuntary separation from employment that vested based on years of service completed before the involuntary separation from employment generally is not a payment that is contingent on a separation from employment because the payment would be paid at some point, and the separation from employment may impact the time of, but not the right to, the payment. Similarly, medical benefits that vested based on years of service completed before an involuntary separation from employment but that are provided after the involuntary separation from employment generally are not treated as payments that are contingent on a separation from employment.

Q/A–20 also provides that an amount that was included in gross income in a previous year and excess remuneration that was treated as paid under Q/A–13 before the separation from employment are not contingent on the separation from employment.

Therefore, while these amounts may be included in the employee's base amount, payments of these amounts are not parachute payments.

Q/A–24 provides that if a payment is accelerated or a substantial risk of forfeiture lapses as a result of an involuntary separation from employment, the additional value due to the acceleration is treated as a payment contingent on a separation from employment. Q/A–24 is based on the rules of Treas. Reg. § 1.280G-1, Q/A–24(b) and (c) for purposes of determining the value of these accelerations.

Notwithstanding the foregoing, if the facts and circumstances demonstrate that either vesting or payment of an amount (whether before or after the involuntary separation from employment) would not have occurred but for the involuntary nature of the separation from employment, the amount will be treated as contingent on a separation from employment. For example, an employer's exercise of discretion to accelerate vesting of an amount shortly before an involuntary separation from employment may indicate that the acceleration of vesting was due to the involuntary nature of the separation from employment and, thus, was contingent on the employee's separation from employment. Similarly, payment of an amount in excess of an amount otherwise payable (for example, increased salary) shortly before or after an involuntary separation from employment may indicate that the amount was paid because the separation was involuntary and, thus, was contingent on the employee's separation from employment.

Q/A–21 provides that payments pursuant to certain window programs are treated as payments contingent on a separation from employment and is based on Treas. Reg. § 1.409A-1(b)(9).

Q/A–23 generally adopts the standards of the regulations under section 409A for purposes of determining whether there has been a separation from employment, except that a bona fide change from employee to independent contractor status is treated as a separation from employment. However, the IRS may assert based on all the facts and circumstances that there was not a bona fide change from employee to independent contractor status. Specifically, Q/A–23 adopts the standards of Treas. Reg. § 1.409A-1(h)(1)(ii), providing that an anticipated reduction in the level of services of more than 80 percent is treated as a separation from employment and an anticipated reduction in the level of services of less than 50 percent is not treated as a separation from employment, with the treatment of an anticipated reduction between these two levels depending on the facts and circumstances. The guidance in this notice does not adopt the rule of Treas. Reg. § 1.409A-1(h)(1)(ii) under which an employer may modify the level of the anticipated reduction in future services that will be considered to result in a separation from employment. Instead, the default 80 percent and 50 percent levels provided under Treas. Reg. § 1.409A-1(h)(1)(ii) apply for purposes of section 4960.

Unlike Q/A–25 and Q/A–26 of Treas. Reg. § 1.280G-1, the guidance in this notice does not provide a presumption that a payment made pursuant to an agreement entered into or modified within twelve months of a separation from employment is a payment that is contingent on a separation from employment. However, as noted previously, if the facts and circumstances demonstrate that either the vesting or the payment of an amount would not have occurred but for the involuntary nature of the separation from employment, the amount will be treated as a payment contingent on a separation from employment.

In addition, the guidance in this notice does not incorporate Treas. Reg. § 1.280G-1, Q/A–9, excluding reasonable compensation for services from the definition of parachute payment. In many cases, whether payments after a separation from employment are reasonable compensation for services will not be an issue because the employee will not provide services after the separation from employment. However, if the employee continues to provide services (including as a bona fide independent contractor) after a separation from employment, payments for those services are not contingent on the involuntary separation from employment to the extent those payments are reasonable and are not made due to the involuntary nature of the separation from employment.

Finally, the guidance in this notice does not include a rule similar to Treas. Reg. § 1.280G-1, Q/A–16, under which a personal service corporation (PSC) is treated as an employee. Q/A–3 provides that section 4960 applies to amounts paid to common law employees who are covered employees of an ATEO. Although a PSC that performs services for an ATEO is not treated as an employee, the IRS may assert that the individual owner of a PSC is in fact a common law employee of an ATEO based on all the facts and circumstances.

#### **G. Three-Times-Base-Amount Test for Parachute Payments**

Section 4960(c)(5)(B) provides that a payment is a parachute payment only if the aggregate present value of the payments in the nature of compensation to (or for the benefit of) an individual that are contingent on a separation from employment equals or exceeds an amount equal to three times the base amount.

Section 4960(c)(5)(D) provides that rules similar to the rules of section 280G(b)(3) apply for purposes of determining the base amount, and section 4960(c)(5)(E) provides that rules similar to the rules of paragraphs (3) and (4) of section 280G(d) apply for purposes of present value determinations.

Section 280G(b)(3) provides that the term “base amount” means an individual’s annualized includible compensation for a base period. Section 280G(d)(2) defines “base period” as the period consisting of the five most recent taxable years of the service provider ending before the date on which the change in ownership or control occurs or the portion of such period during which the individual performed personal services for the corporation. Section 280G(d)(3) provides that any transfer of property is treated as a payment and is taken into account at its fair market value.

Section 280G(d)(4) provides that present value is determined using a discount rate equal to 120 percent of the applicable Federal rate determined under section 1274(d), compounded semiannually.

Q/A–25 through Q/A–31 are based on the rules under Treas. Reg. § 1.280G-1, Q/A–30 through Q/A–35 (substituting an involuntary separation from employment for a change in control) for determining whether a payment is an excess parachute payment, including the rules for applying the three-times-base-amount test, determining the base amount and base period, and determining present value, including determining the present value of payments that are contingent on uncertain future events.

#### **H. Computation of Excess Parachute Payments**

Section 4960(c)(5)(A) provides that an “excess parachute payment” is an amount equal to the excess of any parachute payment over the portion of the base amount

allocated to such payment. Q/A–32(a) is based on Treas. Reg. § 1.280G-1, Q/A–38, regarding allocating the base amount to a parachute payment (that is, determining the portion that is not a parachute payment because it does not exceed the base amount). Q/A-2 provides that the excise tax on excess parachute payments for a taxable year is based on any excess parachute payments made in the calendar year ending with or within the taxable year of the ATEO.

#### **I. Reporting Liability Under Section 4960**

As requested by some commenters, Q/A-34 provides guidance as to the reporting and due date for paying the section 4960 excise tax. On November 7, 2018, the Treasury Department and the IRS issued proposed regulations under sections 6011 and 6071 (Prop. Treas. Reg. §§ 53.6011-1 and 53.6071-1, 83 F.R. 55653) to address reporting and the due date for paying the tax. The proposed regulations provide that the excise tax under section 4960 is reported on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code, which is the form generally used for reporting and paying chapter 42 taxes. Each employer liable for section 4960 tax, whether an ATEO or a related organization described in section 4960(c)(4)(B), is responsible for separately reporting and paying its share of the tax. The proposed regulations provide that Form 4720 and payment are due when chapter 42 taxes ordinarily are due (the 15th day of the 5th month after the end of the taxpayer’s taxable year—May 15 for a calendar year employer), subject to an extension of time for filing that generally applies. This rule is also reflected in Q/A–34(a).

Q/A–34(b) provides that an employer may elect to prepay the excise tax imposed under section 4960(a)(2) in the year of separation from employment (or any taxable

year prior to the year in which the parachute payment is actually paid). This rule is similar to the rule in Treas. Reg. § 1.280G-1, Q/A–11(c), under which a disqualified employee may elect to prepay the excise tax under section 4999 based on the present value of the excise tax that would be owed by the employee when the parachute payments are actually made.

Some commenters requested clarification as to whether section 4960 excise tax is subject to quarterly payments of estimated tax under section 6655. Since section 6655 was not amended to include section 4960, no quarterly payments of estimated section 4960 tax are required under section 6655. See Q/A–35.

#### **J. Miscellaneous Issues**

Q/A–36 through Q/A–38 address coordination of section 4960 with other Code provisions. Commenters requested clarification of the relationship between the section 4960 excise tax and excise taxes for unreasonable or excessive compensation under section 4958 or, in the case of compensation to disqualified persons for personal services, section 4941. Q/A–36 and Q/A–37 confirm that there is no particular relationship between liability for excise tax under section 4960 and liability under these other provisions. In cases involving excessive compensation for purposes of section 4958 or section 4941, there may or may not be concurrent excise tax liability under section 4960, and in cases involving section 4960 excise tax liability, there may or may not be concurrent liability under section 4958 or section 4941.

Q/A–38 addresses the rule under section 4960(c)(6) that remuneration for which a deduction is disallowed under section 162(m) is not taken into account under section 4960. For example, an ATEO's covered employee may also be a covered

employee of a publicly held corporation (as those terms are defined in section 162(m)(2) and (3)) if the publicly held corporation is related to the ATEO under section 4960(c)(4)(B). In that case, any portion of remuneration disallowed as a deduction by reason of section 162(m) is not taken into account under section 4960.

#### **K. Effective Date**

Section 4960 is effective for the first taxable year beginning after December 31, 2017. Q/A–39 provides that amounts paid before the beginning of that taxable year are not subject to the excise tax under section 4960. As described previously in the discussion of remuneration for purposes of section 4960(a)(1), remuneration that was vested before the effective date of section 4960 is not subject to excise tax under section 4960 because it is treated as having been paid at vesting. For example, amounts includible in gross income under section 457(f)(1)(A) and any vested earnings that accrued before the effective date of section 4960 are not subject to the excise tax under section 4960. However, earnings accrued on those amounts in taxable years beginning after December 31, 2017, may be subject to excise tax under section 4960(a)(1).

### **II. INTERIM GUIDANCE ON APPLICATION OF SECTION 4960**

#### **A. Section 4960 — In General**

##### **Q–1: What is the effect of section 4960?**

A–1: An ATEO or related organization that pays excess remuneration or an excess parachute payment to a covered employee is subject to an excise tax on that amount at a rate equal to the rate of tax under section 11. For taxable years beginning after

December 31, 2017, the rate of tax under section 11 is 21 percent. See section 13001 of the Act.

**Q–2: What year is used in calculating the section 4960 excise tax?**

A–2: Excess remuneration paid and excess parachute payments made in the calendar year ending with or within the taxable year of an ATEO or a related organization, whichever is the applicable employer, are treated as paid for that taxable year. Thus, the excise tax on excess remuneration and excess parachute payments is calculated based on excess remuneration paid and excess parachute payments made during the calendar year ending with or within the employer's taxable year.

**Q–3: Who is liable for the section 4960 excise tax?**

A–3: (a) In general. The common-law employer, as generally determined for federal tax purposes, is liable for the excise tax imposed under section 4960. Only an ATEO has covered employees, but a covered employee may also be an employee of a related organization. When an employer that is an ATEO or a related organization pays a covered employee either excess remuneration or an excess parachute payment, each employer is liable for the excise tax under section 4960. See Q/A–14 for rules that apply when more than one employer is liable for the excise tax on excess remuneration.

Whether a person or entity is the common-law employer generally depends on the facts and circumstances. A common-law employer may not avoid liability under section 4960 by reason of a third party payor arrangement, such as an arrangement with a payroll agent, common paymaster, statutory employer under section 3401(d)(1), or certified professional employer organization, or any similar arrangement. For purposes of section 4960, a payment to an employee by a third-party payor is

considered paid by the common-law employer with respect to the services for which the payment is made. Similarly, a payment to an employee on behalf of the common-law employer (such as a payment from a related organization for which the individual is not providing services as an employee or a payment from an unrelated management company), is considered paid by the common-law employer for purposes of section 4960.

(b) Disregarded entities. In the case of employment by a disregarded entity described in Treas. Reg. § 301.7701-3, the sole owner of the disregarded entity is treated as the common-law employer for purposes of section 4960.

(c) Arrangements between an ATEO and a related organization. Calculation of, and liability for, the excise tax based on excess remuneration or an excess parachute payment in accordance with this Q/A–3 is separate from and unaffected by any arrangement that the ATEO and any related organization may have for bearing the cost of any excise tax liability under section 4960.

## **B. Applicable Tax-Exempt Organizations and Related Organizations**

### **Q–4: What is an applicable tax-exempt organization within the meaning of section 4960(c)(1)?**

A–4: As provided in section 4960(c)(1), an ATEO is any organization which for its taxable year–

- (A) is exempt from taxation under section 501(a),
- (B) is a farmers' cooperative organization described in section 521(b)(1),
- (C) has income excluded from taxation under section 115(1), or
- (D) is a political organization described in section 527(e)(1).

**Q–5: When is a governmental entity an applicable tax-exempt organization within the meaning of section 4960(c)(1)?**

A–5: Governmental entities specifically described in section 4960(c)(1), that is, organizations that have income excluded from taxation under section 115(1) and organizations that are exempt from taxation under section 501(a), are ATEOs. For example, federal instrumentalities exempt from tax under section 501(c)(1) and public universities with IRS determination letters recognizing their tax-exempt status under section 501(c)(3) are governmental entities exempt from tax under section 501(a), and thus are ATEOs.

A governmental entity that is separately organized from a state or political subdivision of a state may meet the requirements to exclude income from gross income (and thereby have income excluded from taxation) under section 115(1). See Rev. Rul. 77-261, 1977-2 C.B.45. However, a state, political subdivision of a state, or integral part of a state or political subdivision, often referred to as a “governmental unit,” does not meet the requirements to exclude income from gross income under section 115(1) because section 115(1) does not apply to income from an activity that the state conducts directly, rather than through a separate entity. See Rev. Rul. 77-261; see also Rev. Rul. 71-131, 1971-1 C.B. 28 (superseding and restating the position stated in G.C.M. 14407, C.B. XIV-1 103).

Instead, under the doctrine of implied statutory immunity, the income of a governmental unit generally is not taxable in the absence of specific statutory authorization for taxing that income. See Rev. Rul. 87-2, 1987-1 C.B. 18; Rev. Rul. 71-131; Rev. Rul. 71-132, 1971-1 C.B. 29; and G.C.M. 14407. Section 511(a)(2)(B), which imposes tax on the unrelated business taxable income of state colleges and

universities, is an example of a specific statutory authorization for taxing income earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision of a state.

Thus, a governmental unit (including a state college or university) that does not have a determination letter recognizing its exemption from taxation under section 501(a) and does not exclude income from gross income under section 115(1) is not an ATEO described in section 4960(c)(1). However, such a governmental unit may be liable for excise tax under section 4960 if it is a related organization under section 4960(c)(4)(B) with respect to an ATEO.

**Q–6: May a governmental entity with a determination letter recognizing its tax exemption relinquish its section 501(c)(3) status?**

A–6: Yes, a governmental entity may voluntarily relinquish its section 501(c)(3) tax-exempt status pursuant to section 3.01(12) of Rev. Proc. 2018-5, 2018-1 I.R.B. 233, 239 (or the analogous section in any successor revenue procedure), under the procedures described in that revenue procedure.

**Q–7: What is a related organization for purposes of section 4960?**

A–7: As provided in section 4960(c)(4)(B), a person or governmental entity is related to an ATEO if such person or governmental entity—

- (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;
- (iv) is a supporting organization described in section 509(a)(3) with respect to the ATEO; or

(v) in the case of an ATEO which is a voluntary employees' beneficiary association described in section 501(c)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.

See Q/A–14(c) for rules regarding a change in related status during the year.

**Q–8: What is the meaning of “control” for purposes of section 4960(c)(4)(B)(i)-(ii) and Q/A–7 of this notice?**

A–8: (a) In general. For purposes of section 4960(c)(4)(B)(i)-(ii) and Q/A–7 of this notice, the term “control” is defined as follows:

(1) Stock corporation. In the case of a stock corporation, control means ownership (by vote or value) of more than 50 percent of the stock in such corporation.

(2) Partnership. In the case of a partnership, control means ownership of more than 50 percent of the profits interest or capital interest in such partnership.

(3) Trust. In the case of a trust with beneficial interests, control means ownership of more than 50 percent of the beneficial interests in the trust.

(4) Nonstock organization. In the case of a nonprofit organization or other organization without owners or persons having beneficial interests (nonstock organization), including a governmental entity, control means that (i) more than 50 percent of the directors or trustees of the ATEO or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity; or (ii) more than 50 percent of the directors or trustees of the nonstock organization are either representatives of, or are directly or indirectly controlled by, one or more persons that control the ATEO. For purposes of this paragraph, a “representative” means a trustee, director, agent, or employee, and control includes the power to remove a trustee or director and designate a new trustee or director.

(5) Constructive ownership. For purposes of Q/A-7 and this Q/A-8, section 318 (relating to constructive ownership of stock) applies for purposes of determining control of stock in a corporation. For purposes of determining control of any other entity, including a nonstock organization, under this Q/A-8, the principles of section 318 apply.

(b) Examples. The following examples illustrate how the rules of Q/A-7 and this Q/A-8 apply:

**Example 1.** A, B, and C are nonstock organizations and are ATEOs within the meaning of section 4960(c)(1). C owns 80 percent of the stock of corporation D. Eighty percent of B's directors are representatives of A. In addition, 80 percent of C's directors are representatives of A. A is a related organization with respect to B (and vice versa) because more than 50 percent of B's directors are representatives of A; thus, A controls B. Based on the same analysis, A is also a related organization with respect to C (and vice versa). D is a related organization with respect to C because, as the owner of more than 50 percent of D's stock, C controls D. Applying the principles of section 318, A is deemed to own 64 percent of the stock of D (80 percent of C's stock in D). Thus, D is a related organization with respect to A because A controls D. B is a related organization with respect to C, C is a related organization with respect to B, and D is a related organization with respect to B because B, C, and D are all controlled by the same person (A).

**Example 2.** X, Y, and Z are nonstock organizations and are ATEOs within the meaning of section 4960(c)(1). Sixty percent of Y's directors are representatives of X. In addition, 60 percent of Z's directors are representatives of Y. X is a related organization with respect to Y (and vice versa) because more than 50 percent of Y's directors are representatives of X; thus, X controls Y. Based on the same analysis, Z is a related organization with respect to Y (and vice versa). Applying the principles of section 318, X is deemed to control 36 percent of Z's directors (60 percent of Y's 60 percent control over Z). Because less than 50 percent of Z's directors are representatives of or controlled by X, and absent any facts suggesting that X directly or indirectly controls Z, X is not a related organization with respect to Z.

### **C. Covered Employees**

#### **Q-9: Who is a covered employee within the meaning of section 4960(c)(2)?**

A-9: The term "covered employee" means any employee (including any former employee) of an ATEO, if the employee—

(A) is one of the five highest-compensated employees of the organization for the taxable year of the ATEO, or

(B) was a covered employee of the ATEO (or any predecessor) for any of the ATEO's preceding taxable years beginning after December 31, 2016.

**Q–10: How are the five highest-compensated employees determined?**

A–10: (a) In general. Except as provided in Q/A–10(b), the determination of whether an employee is one of the five highest-compensated employees of an ATEO is made on the basis of his or her remuneration for services performed as an employee of the ATEO, including remuneration for services performed as an employee of a related organization with respect to the ATEO. The remuneration used for purposes of identifying the five highest-compensated employees is the remuneration paid to an employee during the calendar year ending with or within the ATEO's or related organization's taxable year. Remuneration paid for medical services (or veterinary services) is not taken into account for purposes of identifying the five highest-compensated employees.

(b) Limited services exception. An employee is not one of an ATEO's five highest-compensated employees for a taxable year if, during the calendar year ending with or within the taxable year, as described in Q/A–2, the ATEO paid less than 10 percent of the employee's total remuneration for services performed as an employee of the ATEO and all related organizations. However, if an employee would not be treated as one of the five highest-compensated employees of any ATEO in an ATEO's group of related organizations because no ATEO in the group paid at least 10 percent of the total

remuneration paid by the group during the calendar year, then this exception does not apply to the ATEO that paid the employee the most remuneration during that year.

(c) Examples. The following examples illustrate the rules of this Q/A–10:

**Example 1.** X and Y are both calendar year taxpayers and ATEOs that are related organizations with respect to each other, and both employ E during calendar year 2020. Of the total remuneration paid to E for services performed as an employee of X and Y, 50 percent was for services for X and 50 percent was for services for Y. Based on the aggregate remuneration from X and Y, E is one of the five highest-compensated employees of both X and Y. E is a covered employee of both X and Y for 2020 and all future taxable years.

**Example 2.** Assume the same facts as **Example 1**, except that of the total remuneration paid to E for services performed as an employee of X and Y, 95 percent was for services for X and 5 percent was for services for Y. E is a covered employee of X for 2020 and all future taxable years, but is not a covered employee of Y for 2020 because Y did not pay at least 10 percent of the total remuneration paid to E by Y and all related organizations and at least one other related ATEO paid at least 10 percent of that remuneration.

#### **D. Excess Remuneration**

**Q–11: What is excess remuneration paid by an applicable tax-exempt organization under section 4960(a)(1)?**

A–11: For each covered employee, excess remuneration is the excess (if any) for a taxable year of the remuneration that is paid (other than any excess parachute payment) by an ATEO, including remuneration paid by a related organization, over \$1 million for the taxable year.

**Q–12: What is remuneration under section 4960(c)(3)?**

A–12: (a) General rule. The term “remuneration” has the same meaning as the term “wages,” as defined in section 3401(a), except that it excludes any designated Roth contribution (as defined in section 402A(c)) and includes amounts required to be included in gross income under section 457(f). Remuneration includes an amount that is a parachute payment; however, a parachute payment is not subject to tax as excess

remuneration if it is also subject to tax as an excess parachute payment. Further, remuneration does not include the portion of any remuneration paid to a licensed medical professional (including a veterinarian) that is directly related to the performance of medical or veterinary services by such professional.

(b) Section 3401(a) wages. Section 3401(a) provides that the term “wages” generally means all remuneration for services performed by an employee for his employer (with certain exceptions provided under section 3401(a)(1) through (a)(23)), including the cash value of all remuneration (including benefits) paid in any medium other than cash. Among the more broadly applicable exclusions, section 3401(a)(12) provides that wages do not include remuneration paid to, or on behalf of, an employee or his beneficiary—

(1) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust;

(2) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a);

(3) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment;

(4) under an arrangement to which section 408(p) applies; or

(5) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) that is maintained by an eligible employer described in section 457(e)(1)(A) (governmental employer).

(c) Remuneration paid by related organizations. Remuneration includes remuneration paid to a covered employee by any related organization with respect to the employee's employment by that related organization. (See Q/A–14(b) for rules on allocating the liability for the excise tax when remuneration from more than one employer is taken into account in determining the liability for the excise tax under section 4960(a)(1).) In contrast, remuneration paid by another organization, whether or not a related organization, with respect to an employee's employment by an ATEO, is treated as remuneration paid by that ATEO for purposes of section 4960.

(d) Directors. Compensation paid by an organization to a member of its board of directors (or an individual holding a substantially similar position) for serving in that capacity is not remuneration because the fees received by the director for performing those services constitute self-employment income, rather than wages under section 3401(a). See Rev. Rul. 57-246, 1957-1 C.B. 338. If the individual also performs services for the organization as an employee, then the compensation paid for the services as an employee is remuneration. Moreover, for purposes of section 4960, compensation that an employer pays to an employee to serve as a director of another organization is remuneration.

**Q–13: When is remuneration treated as paid for purposes of section 4960(a)(1)?**

A–13: (a) General rule. For purposes of section 4960(a)(1), remuneration is paid for a taxable year if it is paid during the calendar year ending with or within the employer's

taxable year. Remuneration is treated as paid on the first date that the right to the remuneration is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) (regardless of whether the arrangement under which the amount is or will be paid is subject to section 457(f) or section 409A). An amount of remuneration is subject to a substantial risk of forfeiture if the right to the remuneration would be treated as subject to a substantial risk of forfeiture under Prop. Treas. Reg. § 1.457-12(e)(1). In general, this means that the amount is subject to a substantial risk of forfeiture only if entitlement to the amount is conditioned on the future performance of substantial services, or upon the occurrence of a condition that is related to a purpose of the remuneration if the possibility of forfeiture is substantial. See Prop. Treas. Reg. § 1.457-12(e)(1) for further guidance on the application of this standard.<sup>5</sup> For purposes of this notice, remuneration that is no longer subject to a substantial risk of forfeiture is referred to as “vested” remuneration and the lapsing of a substantial risk of forfeiture is referred to as “vesting.”

(b) Amount of remuneration treated as paid – (1) In general. The amount of remuneration treated as paid upon vesting is the present value (on the vesting date) of the future payments to which the participant has a legally binding right. The present value of the right to future payments as of the vesting date includes any earnings that have accrued as of the vesting date. The present value must be determined using

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<sup>5</sup> When the proposed regulations under section 457(f) are finalized, the Treasury Department and the IRS anticipate providing further guidance on how and when those final regulations apply for purposes of section 4960.

reasonable actuarial assumptions. Present value determined in accordance with the rules set forth in Prop. Treas. Reg. § 1.457-12(c)(1), including the assumptions regarding payment timing set forth in those proposed regulations, will be deemed to have been determined using reasonable actuarial assumptions. For purposes of determining the present value of remuneration under a nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) that is scheduled to be actually or constructively paid within 90 days of vesting, the employer may elect to treat the nominal amount that is to be paid as the present value of the amount on the date of vesting.

Net earnings, as defined in paragraph (b)(2)(C), on previously paid remuneration, as defined in paragraph (b)(2)(D)(i), are treated as paid at the close of the calendar year in which they accrue. For example, the present value of vested remuneration credited to an employee's account under an account balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(A) (under which the earnings and losses attributed to the account are based solely on a predetermined actual investment or a reasonable market interest rate) is treated as paid on the date credited to the employee's account, but the present value of any net earnings accrued on that amount (the increase in value due to the predetermined actual investment or a reasonable market interest rate) is treated as paid at the close of the calendar year in which they accrue. Similarly, the present value of a vested, fixed amount of remuneration under a nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) is treated as paid on the date of vesting, but the present value of the net earnings on that amount (the increase in the present value) is treated as paid at the close of the calendar year in which they accrue.

(2) Earnings and losses. (A) Earnings. Earnings generally refer to any increase in the vested present value of any previously paid remuneration as of the close of a calendar year, regardless of whether the plan or arrangement denominates such increase as earnings, to the extent the employee's right to payment of the increase is vested. For example, an increase in the vested account balance of a nonqualified deferred compensation plan based solely on the investment return of a predetermined actual investment (and disregarding any additional contributions) constitutes earnings. Similarly, an increase in the vested present value of a benefit under a nonqualified nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) due solely to the passage of time (and disregarding any additional benefit accruals) constitutes earnings. However, an increase in an account balance of a nonqualified deferred compensation plan due to a salary reduction contribution or an employer contribution does not constitute earnings. Likewise, an increase in the benefit under a nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) due to an additional year of service or an increase in compensation that is reflected in a benefit formula does not constitute earnings.

(B) Losses. Losses generally refer to any decrease in the vested present value of any previously paid remuneration as of the close of the calendar year, regardless of whether the plan denominates that decrease as losses.

(C) Net earnings and losses. Net earnings and losses for each covered employee are determined on a net aggregate basis for each taxable year based on the previously paid remuneration paid by the employer. For example, losses under an account balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(A) may offset

earnings under a nonaccount balance plan described in Treas. Reg. § 1.409A-1(c)(2)(i)(C) maintained by the same employer for the same employee, but earnings and losses from a plan maintained by another employer are disregarded.

Net earnings refer to the amount (if any) by which the earnings accrued during a calendar year ending with or within the taxable year (as described in Q/A–2) on any previously paid remuneration exceeds the sum of the losses accrued on those amounts during that calendar year and any net losses carried forward from a previous taxable year. Net losses refer to the amount (if any) by which the sum of the losses accrued during a calendar year ending with or within the taxable year (as described in Q/A–2) on any previously paid remuneration and the net losses carried forward from a previous taxable year exceeds the earnings accrued on those amounts during that calendar year. Losses do not reduce the remuneration treated as paid in a calendar year except to the extent of the earnings for that calendar year. Thus, if an employee vests in an amount of earnings under a nonaccount balance plan within the meaning of Treas. Reg. § 1.409A-1(c)(2)(i)(C), and also has losses under an account balance plan within the meaning of Treas. Reg. § 1.409A-1(c)(2)(i)(A) that exceed the vested earnings treated as remuneration under the nonaccount balance plan, those excess losses are carried forward to the next following taxable year and offset vested earnings for purposes of determining net earnings or losses for that taxable year. If, for the next following year, there are not sufficient earnings to offset the entire amount of losses carried forward from the previous year (and any additional losses), the offset process repeats for each later year until there are earnings for the calendar year in excess of the losses carried forward.

(D) Previously paid remuneration – (i) In general. Remuneration is treated as previously paid remuneration for a taxable year to the extent that, by the close of the calendar year ending with or within such taxable year (as described in Q/A–2), it is treated as paid under Q/A–13(b)(1) but is not actually or constructively paid.

(ii) Employee who becomes a covered employee. Any remuneration that is vested but is not actually or constructively paid as of the close of the calendar year preceding the calendar year ending with or within the taxable year of the employer for which an employee first becomes a covered employee of an ATEO is treated as paid for the employer’s preceding taxable year. For example, if an employee first becomes a covered employee of an employer for the employer’s taxable year ending June 30, 2022, any remuneration that was vested but was not actually or constructively paid as of December 31, 2020, is treated as paid for the taxable year ending June 30, 2021, and thus is not subject to the excise tax. Net losses from the preceding taxable year do not carry forward to the taxable year an employee becomes a covered employee.

(iii) Pre-effective date remuneration. Any remuneration that was vested but was not actually or constructively paid as of the close of the taxable year preceding the first taxable year in which section 4960 is effective for the employer is treated as paid for the preceding taxable year and is not subject to the excise tax. Thus, for an employer that uses a calendar year taxable year, the present value of any remuneration that was vested but was not actually or constructively paid as of December 31, 2017, is treated as paid for taxable year 2017. For an employer that uses a non-calendar year taxable year, the present value of any remuneration that was vested but was not actually or constructively paid as of the close of the taxable year that includes December 31, 2017

(for example, June 30, 2018 in the case of an employer with a taxable year beginning July 1 and ending June 30) is treated as paid for that taxable year. Regardless of the employer's taxable year, there is no carryover of net losses from the preceding taxable year to the first taxable year for which section 4960 is effective.

(c) Examples. The following examples illustrate the rules described in this Q/A–13.

**Example 1.** E is a covered employee of R, an ATEO that uses a calendar year taxable year. E participates in a nonqualified deferred compensation plan in which the account balance is adjusted based on the investment returns on predetermined actual investments chosen by the employee. On January 1, 2019, R credits \$100,000 to E's account under the plan, subject to the requirement that E remain employed through June 30, 2021. On June 30, 2021, the vested account balance is \$110,000. Due to earnings or losses on the account balance, the closing account balance on each of the following dates is: (i) \$115,000 on December 31, 2021, (ii) \$120,000 on December 31, 2022, (iii) \$100,000 on December 31, 2023, and (iv) \$110,000 on December 31, 2024. During 2025, E defers an additional \$10,000 under the plan, which is vested at the time of deferral. On December 31, 2025, the closing account balance is \$125,000. In 2026, R distributes \$10,000 to E under the plan. On December 31, 2026, the closing account balance is \$135,000 due to earnings on the account balance.

2019 and 2020 (nonvested amounts). For 2019 and 2020, R pays no remuneration to E under the plan. The substantial future services condition is not met; thus, any amount deferred under the plan, including unvested earnings, remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) as of December 31, 2019, and December 31, 2020.

2021 (amounts in year of vesting). For 2021, R pays E \$115,000 of remuneration, including (i) \$110,000 of remuneration on June 30, 2021, when the substantial future services condition is met and the amount is no longer subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B), and (ii) an additional \$5,000 of earnings on the previously paid remuneration (\$110,000) on December 31, 2021.

2022 (earnings). For 2022, R pays E \$5,000 of remuneration, the additional earnings on the previously paid remuneration (\$115,000) as of December 31, 2022.

2023 (losses). For 2023, R pays no remuneration to E since the vested present value of the previously paid remuneration (\$120,000) declines to \$100,000 as of December 31, 2023. The \$20,000 loss for 2023 does not reduce any amount previously treated as remuneration but is available for carry over to future taxable years.

2024 (recovery of losses through earnings). For 2024, R pays no remuneration to E, since the vested present value of the previously paid remuneration (\$120,000) was \$110,000 as of December 31, 2024. Due to earnings on the account balance, R recovers \$10,000 of the \$20,000 of losses carried over from 2023. The net losses as of December 31, 2024, are \$10,000, and none of the \$10,000 in earnings during 2024 is remuneration paid in 2024.

2025 (no recovery of losses against additional deferrals of compensation). For 2025, R pays E \$10,000 of remuneration to E. The additional \$10,000 deferral is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B), and thus is remuneration paid on the date deferred. This deferral increases the amount previously treated as remuneration from \$120,000 to \$130,000. Additionally, due to earnings on the account balance, R recovers \$5,000 of losses of the \$10,000 of losses carried over from 2024, none of which was remuneration for 2025, so that the net losses as of December 31, 2025 is \$5,000.

2026 (distributions, recovery of remainder of losses through earnings and additional earnings). For 2026, R pays E \$15,000 in remuneration. The vested present value of the account balance increases by \$20,000 to \$135,000 as of December 31, 2026. Therefore, due to earnings on the account balance, R recovers the remaining \$5,000 of losses carried over from 2025 and pays E an additional \$15,000 of remuneration as earnings. The \$10,000 distribution reduces the amount of previously paid remuneration (\$130,000) to \$120,000, and the additional remuneration paid in 2026 increases the amount of previously paid remuneration by \$15,000 to \$135,000.

**Example 2.** F is a covered employee of S, an ATEO, and is also employed by corporation C, a related organization. S and C are calendar year taxpayers. On January 1, 2018, C and F enter into an agreement under which C will pay F \$100,000 on December 31, 2021, if F remains employed by C through January 1, 2020. F remains employed by C through January 1, 2020. On January 1, 2020, the present value based on reasonable actuarial assumptions of the \$100,000 to be paid on December 31, 2021 is \$75,000. On December 31, 2020, the vested present value increases to \$85,000 due solely to the passage of time. On December 31, 2021, C pays F \$100,000.

2018 and 2019. For 2018 and 2019, C pays F no remuneration because the amount deferred under the plan remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B).

2020. For 2020, C pays F \$75,000 in remuneration on January 1, 2020, which is the vested present value of \$100,000 payable on December 31, 2021. In addition C pays F an additional \$10,000 in remuneration on December 31, 2020 as earnings based on the increase in the vested present value of the previously paid remuneration (\$75,000) to \$85,000 as of December 31, 2020.

2021. For 2021, C pays R \$15,000 in additional remuneration and distributes \$100,000 of previously paid remuneration. The \$100,000 distribution is treated as reducing the amount of previously paid remuneration (\$85,000) to zero, and the remaining \$15,000 is a payment of earnings.

**Example 3.** G is a covered employee of T, an ATEO that uses a calendar year taxable year. G participates in a nonqualified deferred compensation plan in which the account balance is adjusted based on the investment returns on predetermined actual investments chosen by the employee. All amounts credited under the plan are vested when credited. On December 31, 2017, T credits \$100,000 to G's account and the closing account balance is \$100,000. On June 30, 2018, T credits \$50,000 to G's account. On December 31, 2018, T credits \$50,000 to G's account and the closing account balance is \$210,000.

2017. T is a calendar year taxpayer, so the present value of all remuneration in which G was vested but that was not actually or constructively paid to G as of December 31, 2017, (\$100,000) is treated as paid for 2017 and is not subject to excise tax under section 4960.

2018. For 2018, T pays G \$110,000 of remuneration, including \$50,000 credited to G's account on June 30 and \$50,000 credited on December 31 (totaling \$100,000), plus \$10,000 in remuneration as earnings, as the vested present value of the \$200,000 of previously paid remuneration (\$100,000 as of December 31, 2017 + \$100,000 in 2018) increases to \$210,000 as of December 31 2018.

**Example 4.** Assume the same facts as **Example 3**, except that T uses a non-calendar year taxable year that begins on July 1 and ends on June 30. The closing account balance on June 30, 2018 is \$155,000.

Amounts paid through June 30, 2018. T is a non-calendar year taxpayer, so the present value of all remuneration in which G is vested but that is not actually or constructively paid as of the close of the first taxable year ending after December 31, 2017 (June 30, 2018) (\$155,000) is treated as paid for that year and is not subject to excise tax under section 4960.

Amounts paid from July 1 through December 31, 2018. For the taxable year ending June 30, 2019, T pays G \$55,000 in remuneration, including \$50,000 credited to G's account on December 31, 2018, plus \$5,000 in remuneration as earnings, as the previously paid remuneration (\$155,000 as of June 30, 2018 + \$50,000 credited on December 31, 2018) increases to \$210,000 as of December 31, 2018.

**Example 5.** H is an employee of U, an ATEO that uses a calendar year taxable year. H participates in a nonqualified deferred compensation plan in which the account balance is adjusted based on the investment returns on predetermined actual investments chosen by the employee. All amounts credited under the plan are vested when credited. On January 1, 2018, U credits \$100,000 to H's account under the plan. On December 31, 2018, the closing account balance is \$105,000. On January 1, 2019,

U credits \$100,000 to H's account. On December 31, 2019, the closing account balance is \$210,000. H becomes a covered employee of U for U's taxable year ending December 31, 2019.

2018 (remuneration paid before becoming a covered employee). Remuneration that is vested as of the last day of the calendar year preceding the calendar year for which the employee becomes a covered employee is not subject to excise tax under section 4960. Thus, H's vested account balance on December 31, 2018 (\$105,000) is not subject to excise tax under section 4960.

2019 (remuneration in the year an employee becomes a covered employee). For the taxable year ending December 31, 2019, U pays H \$105,000 of remuneration, including the \$100,000 credited to H's account on January 1, 2019, plus \$5,000 in net earnings in 2019, the amount by which the vested account balance at the close of the calendar year (\$210,000) exceeds the amount of previously paid remuneration (\$205,000, consisting of \$105,000 as of December 31, 2018 + \$100,000 paid on January 1, 2019).

**Example 6.** J is a covered employee of T, an ATEO that uses a calendar year taxable year. J participates in a nonqualified deferred compensation plan under which T agrees to pay J \$100,000 two months after the date a specified performance goal that is a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) is satisfied. J satisfies the performance goal on November 30, 2019. T elects to treat the amount to be paid as the present value of the amount at vesting.

Election to treat amount payable within 90 days treated as paid at vesting. For taxable year 2019, T pays J \$100,000 of remuneration. J vests in the \$100,000 amount in 2019 upon meeting the performance goal. Under the general rule, T would be required to treat the present value as of November 30, 2019 of \$100,000 payable in 2020 (two months after the performance goal was met) as paid in 2019, the difference between that amount and the present value as of December 31, 2019 as earnings for 2019, and any difference between the sum of the two present values and \$100,000 as earnings for 2020. However, because T elected to treat the amount of remuneration payable within 90 days of vesting as paid at vesting in 2019, the \$100,000 payable to J in 2020 is treated as remuneration paid in 2019 for purposes of section 4960(a)(1).

**Q-14: How is liability for the section 4960(a)(1) excise tax determined if remuneration is paid to a covered employee by both an applicable tax-exempt organization and a related organization?**

A-14: (a) In general. As provided in section 4960(c)(4)(C), in any case in which an ATEO includes remuneration from one or more other employers of a covered employee that are related organizations in determining the excise tax imposed by section

4960(a)(1), each employer is liable for the excise tax in an amount that bears the same ratio to the total excise tax determined with respect to the remuneration as—

(1) the amount of remuneration paid by the employer with respect to that employee, bears to

(2) the amount of remuneration paid by all the employers to that employee.

(b) Calculation of excise tax involving multiple related organizations. Each ATEO calculates liability for the excise tax under section 4960(a)(1) with respect to a covered employee by including remuneration paid by the ATEO and any related organization that employs the covered employee and then allocating that excise tax liability among each of the employers. However, the ATEO may also be liable for the excise tax under section 4960(a)(1) as a related organization with respect to another ATEO that calculates the excise tax for its own covered employees. If an employer is liable for the excise tax under section 4960(a)(1) as an ATEO and as a related organization for the same remuneration to a covered employee, the employer is not liable for the excise tax in both capacities; rather it is liable for the greater of the excise tax it would owe as an ATEO or the excise tax it would owe as a related organization with respect to that covered employee.

In order to calculate liability under this provision, an ATEO should take the following steps:

(1) calculate remuneration paid (other than any excess parachute payment) for each of its covered employees, including remuneration from any related organization (if remuneration for any covered employee calculated in this step (1) is more than \$1

million, then the remuneration over \$1 million is subject to the excise tax under section 4960(a)(1) at the rate of tax under section 11);

(2) calculate the share of liability for each employer that employs the covered employee that 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 calculated in step (1);

(3) inform any related organization of its share of liability calculated in step (2);

(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; and

(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) (or the share calculated under step (2) if they are the same) as the ATEO's share of liability for remuneration paid to the covered employee.

(c) Change in related status during the year. If an employer becomes or ceases to be a related organization with respect to an ATEO during the calendar year ending with or within the ATEO's taxable year, then only the remuneration paid by the related organization to a covered employee with respect to services performed during that portion of the calendar year that the employer is a related organization is included for purposes of calculating liability for the excise tax under section 4960(a)(1). Thus, only

remuneration that vests while the employer is a related organization with regard to the ATEO is taken into account for purposes of section 4960.

(d) Examples. The following examples illustrate the rules of this Q/A–14.

Assume for purposes of these examples that the rate of excise tax under section 4960 is 21 percent.

**Example 1.** F and G are each ATEOs; G is a related organization with respect to F. E is a covered employee of both F and G. F pays E \$1.2 million of remuneration, and G pays E \$800,000 of remuneration for a total of \$2 million of remuneration, and \$1 million of excess remuneration. The total excise tax is \$210,000 (21 percent of the \$1 million excess remuneration). F paid  $\frac{3}{5}$  of E's total remuneration ( $\$1.2 \text{ million} / \$2 \text{ million}$ ); thus, F is liable for  $\frac{3}{5}$  of the excise tax, which is \$126,000. G is liable for  $\frac{2}{5}$  of the excise tax, which is \$84,000.

**Example 2.** H, I, and J are each ATEOs. J owns 60 percent of the stock of Corporation K. Sixty percent of I's directors are representatives of H. In addition, 60 percent of J's directors are representatives of I. Employee L is a covered employee of H, I, and J. H, I, J, and K each pay Employee L \$1.2 million per year. Under the rules described in Q/A–7 and Q/A–8, I determines that its related organizations are H and J. H determines that its related organization is I. J determines that its related organizations are I and K.

ATEO I. Under I's calculation as an ATEO, Employee L receives a total of \$3.6 million in remuneration from H, I, and J ( $3 \times \$1.2 \text{ million}$ ). The total excise tax is \$546,000 (21 percent of the \$2.6 million excess remuneration). H, I, and J each paid  $\frac{1}{3}$  of the total remuneration to Employee L ( $\$1.2 \text{ million} / \$3.6 \text{ million}$ ); thus, H, I, and J are each liable for  $\frac{1}{3}$  of the excise tax, which is \$182,000.

ATEO H. Under H's calculation as an ATEO, Employee L receives a total of \$2.4 million in remuneration from H and I ( $2 \times \$1.2 \text{ million}$ ). The total excise tax is \$294,000 (21 percent of the \$1,400,000 excess remuneration). H and I each paid  $\frac{1}{2}$  of the total remuneration to Employee L ( $\$1.2 \text{ million} / \$2.4 \text{ million}$ ); thus, H and I are each liable for  $\frac{1}{2}$  of the excise tax, which is \$147,000.

ATEO J. Under J's calculation as an ATEO, L receives a total of \$3.6 million in remuneration from I, J, and K ( $3 \times \$1.2 \text{ million}$ ). The total excise tax is \$546,000 (21 percent of the \$2.6 million excess remuneration). I, J, and K each paid  $\frac{1}{3}$  of the total remuneration to Employee L ( $\$1.2 \text{ million} / \$3.6 \text{ million}$ ); thus, I, J, and K are each liable for  $\frac{1}{3}$  of the excise tax, which is \$182,000.

Liability of H, I, J, and K. I is liable as a related organization for \$147,000 of excise tax according to H's calculation and \$182,000 according to J's calculation, but under I's calculation, I is liable for \$182,000 of excise tax. Thus, I's excise tax liability is

\$182,000. H is liable for \$182,000 of excise tax under I's calculation, which is greater than the \$147,000 of excise tax H calculated under H's calculation. Thus, H's excise tax liability is \$182,000. J is liable as a related organization for \$182,000 of excise tax under I's calculation, but is liable for \$182,000 of excise tax under J's calculation. Thus, J's excise tax liability is \$182,000. K is liable as a related organization for \$182,000 of excise tax according to J's calculation.

#### **E. Medical and Veterinary Services**

##### **Q-15: How is remuneration for medical services treated under section 4960?**

A-15: (a) In general. Remuneration paid to a licensed medical professional for the direct performance of medical services (including nursing services) or veterinary services by the professional is not remuneration for purposes of calculating the excess remuneration (if any) subject to the excise tax. However, remuneration paid to the professional for any other services, including administrative and management services associated with the performance of medical or veterinary services, is remuneration for purposes of calculating the excess remuneration (if any) subject to the excise tax. Remuneration for medical services is also disregarded for purposes of determining whether an individual is a covered employee and for purposes of determining whether a payment is a parachute payment.

(b) Licensed medical professional. A licensed medical professional is an individual who is licensed under state or local law to perform medical services (including nursing services) or veterinary services.

(c) Medical and veterinary services. A licensed medical professional directly performs medical services to the extent that the services constitute "medical care" as defined in section 213(d)(1)(A) and the regulations thereunder. Thus, medical services are 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. For

example, teaching or research services are not medical services to the extent the services performed do not relate directly to the diagnosis, cure, mitigation, treatment, or prevention of disease or affect a structure or function of the body. For purposes of section 4960, documenting the care and condition of a patient is part of the direct performance of medical services, as is accompanying another licensed professional as a supervisor while that medical professional performs medical services. But managing an organization's operations, including scheduling, staffing, appraisal, and other similar functions that may relate to a particular medical professional or professionals who perform medical services, is not the performance of medical services. With respect to veterinary services, the rules in this paragraph apply by analogy to determine whether services performed with respect to an animal are veterinary services.

(d) Allocation. If during a calendar year an employer pays a covered employee remuneration for both medical services and other services, the employer must make a reasonable, good faith allocation between remuneration for medical services and other services. For example, if a medical doctor receives remuneration for both medical services and for administrative or management services, the employer must make a reasonable allocation between remuneration for the medical services and remuneration for the administrative or management services. For this purpose, if an employment agreement or similar written arrangement sets forth the remuneration to be paid for particular services, that allocation of remuneration must be applied unless the facts and circumstances demonstrate that the amount allocated for medical services is unreasonable for those services or that the allocation was established for purposes of avoiding application of the excise tax under section 4960. If some or all of the

remuneration is not reasonably allocated in an employment or other agreement, an employer may use any reasonable allocation method. For example, an employer may use a representative sample of records, such as patient, insurance, and Medicare/Medicaid billing records or internal time reporting mechanisms to determine the time spent providing medical services, and then allocate remuneration to medical services in the proportion such time bears to the total hours the covered employee worked for the employer for purposes of making a reasonable allocation of remuneration. Similarly, if some or all of the remuneration is not reasonably allocated in an employment or other agreement, an employer may use salaries or other remuneration for duties comparable to those the employee performs (for example, hospital administrator and physician) for purposes of making a reasonable allocation between remuneration for medical services and nonmedical services. These same allocation rules also apply with respect to veterinary services.

(e) Examples. The following examples illustrate the rules of this Q/A–15.

Assume for purposes of these examples that there is no employment agreement or similar written arrangement allocating remuneration to any particular services.

**Example 1.** H is a hospital and is an ATEO. A is a covered employee of H. A provides patient care services to H and also provides management and administrative services to H as the head of a medical practice group within H. Based on a representative sample of insurance and Medicare billing records, as well as time reports that A submits to H, H determines that A spends half of her time providing medical care to patients and half of her time performing administrative and management services in her capacity as head of the practice group. H allocates half of A's remuneration to medical services. H's allocation of A's remuneration is a reasonable, good faith allocation. Accordingly, only the portion of A's remuneration allocated to the other, non-medical services is remuneration for purposes of the excise tax.

**Example 2.** R is a medical research organization and is an ATEO. B is a covered employee of R. B is employed to work on a research trial. B provides an experimental treatment to patients afflicted by a disease. B tracks the patients' individual conditions

in a manner that occurs ordinarily in a medical practice. As part of the research trial, B also compiles the patients' records on their individual conditions and prepares reports detailing both individual and overall results. These reports are not ordinarily prepared for patients or provided to patients in a medical practice. Although the primary purpose of B's activities is research, B is treating a patient's disease within the meaning of section 213(d) when B performs services that are ordinarily performed in a medical practice, and, thus, these services are medical services for purposes of section 4960. Accordingly, any remuneration allocable to the medical services is not remuneration for purposes of the excise tax. However, B does not directly perform medical services to the extent B performs research services that are not ordinarily performed in a medical practice; accordingly, any remuneration allocable to those services is remuneration for purposes of section 4960.

**Example 3.** C is a medical doctor who is employed by a university hospital that is an ATEO. C's duties include overseeing and teaching a group of resident physicians who have a restricted license to practice medicine. C's duties include supervising and instructing the resident physicians while they treat patients. C's other duties include instructing the resident physicians in a classroom setting. To the extent that C, in conjunction with the resident physicians, performs services directly related to the diagnosis, cure, mitigation, treatment or prevention of a patient's disease, or affecting a structure or function of the patient's body, those services constitute "medical care" for purposes of section 213(d), and, thus, C directly performs medical services. Accordingly, any remuneration allocable to those medical services is not remuneration for purposes of the excise tax. However, because classroom instruction does not involve actual patient treatment, those activities are not medical care for purposes of section 213(d), and, thus, do not constitute the direct performance of medical services. Accordingly, any remuneration allocable to those services is remuneration for purposes of section 4960.

## **F. Excess Parachute Payments**

### **Q-16: What is an excess parachute payment under section 4960(c)(5)(A)?**

A-16: 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 such payment.

### **Q-17: What is a parachute payment under section 4960(c)(5)(B)?**

A-17: (a) In general. The term "parachute payment" means any payment in the nature of compensation made by an ATEO (or a predecessor organization of the ATEO) or a related organization to (or for the benefit of) a covered employee if—

(1) the payment is contingent on the employee's separation from employment with the employer; and

(2) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) the individual that are contingent on the separation equals or exceeds an amount equal to three times the base amount.

(b) Exclusions. The term “parachute payment” does not include any payment: (1) to or from a plan described in section 401(a) that includes a trust exempt from tax under section 501(a), an annuity plan described in section 403(a), a simplified employee pension (as defined in section 408(k)), or a simple retirement account described in section 408(p);

(2) made under or to an annuity contract described in section 403(b) or a plan described in section 457(b);

(3) made to a licensed medical professional (including a veterinarian) for the performance of medical or veterinary services performed by such professional; or

(4) made to an individual who is not a highly compensated employee as defined in section 414(q). See generally Treas. Reg. § 1.414(q)-1T. Under Treas. Reg. § 1.414(q)-1T, Q/A-14(a)(1), for purposes of determining the group of highly compensated employees for a determination year, the determination year calculation is made on the basis of the applicable year of the plan or other entity for which a determination is made and the look-back year calculation is made on the basis of the twelve month period immediately preceding that year. An ATEO that maintains a qualified retirement plan should have already identified the employees who are HCEs for purposes of the plan and the same individuals are HCEs for purposes of section

4960. For an ATEO that does not maintain a qualified retirement plan, the rules are applied by analogy, substituting the calendar year for the plan year. Accordingly, in 2019, for an ATEO that does not maintain a qualified retirement plan, the ATEO would use the employees' 2018 annual compensation (as defined in Treas. Reg. § 1.414(q)-1T Q/A-13, including any of the safe harbor definitions if applied consistently to all employees) to determine whether and which employees were HCEs for 2019 for purposes of section 4960. If an employee is an HCE at the time of the separation from employment, then any parachute payment made as a consequence of the separation from employment is treated as paid to an HCE, even if the payments occur during one or more later taxable years (that is, taxable years after the taxable year during which the employee separated from employment).

**Q-18: What is a payment in the nature of compensation?**

A-18: For purposes of section 4960(a)(2), any payment—in whatever form—is a payment in the nature of compensation if the payment arises out of an employment relationship, including holding oneself out as available to perform services and refraining from performing services. Thus, for example, payments made under a covenant not to compete or a similar arrangement are payments in the nature of compensation. A payment in the nature of compensation includes (but is not limited to) wages and salary, bonuses, severance pay, fringe benefits, life insurance, pension benefits, and other deferred compensation (including any amount characterized by the parties as interest or earnings thereon). A payment in the nature of compensation also includes cash when paid, the value of the right to receive cash, including the value of accelerated vesting, or a transfer of property. However, a payment in the nature of

compensation does not include attorney's fees or court costs paid or incurred in connection with the payment of any parachute payment or a reasonable rate of interest accrued on any amount during the period the parties contest whether a payment will be made.

**Q–19: When is a payment in the nature of compensation considered to be made?**

A–19: (a) In general. A payment in the nature of compensation is considered made in the taxable year in which it is includible in the covered employee's gross income (in the case of taxable non-cash fringe benefits, consistent with Announcement 85-113, 1985-31 I.R.B. 31) or, in the case of fringe benefits and other benefits that are excludible from income, in the taxable year the benefits are received.

(b) Transfers of section 83 property. A transfer of property in connection with the performance of services that is subject to section 83 is considered a payment made in the taxable year in which the property is transferred or would be includible in the gross income of the covered employee under section 83 and the regulations thereunder, disregarding any election made by the employee under section 83(b) or 83(i). Thus, in general, such a payment is considered made at the later of the date the property is transferred (as defined in Treas. Reg. § 1.83-3(a)) to the covered employee or the date the property becomes substantially vested (as defined in Treas. Reg. § 1.83-3(b) and (j)). The amount of the payment is the compensation income as determined under section 83 and the regulations thereunder, disregarding any amount includible in income pursuant to an election made by an employee under section 83(b).

(c) Stock options and stock appreciation rights. For purposes of this Q/A–19, an option (including an option to which section 421 applies) is treated as property that is

transferred when the option becomes vested (regardless of whether the option has a readily ascertainable fair market value as defined in Treas. Reg. § 1.83-7(b)). For purposes of determining the timing and amount of any payment related to the option, the principles of Treas. Reg. § 1.280G-1, Q/A–13 and Rev. Proc. 2003-68, 2003-2 C.B. 398, apply. Thus, the vesting of an option as a result of a covered employee's separation from employment is a payment in the nature of compensation.

(d) Consideration paid by covered employee. Any payment in the nature of compensation is reduced by the amount of any money or the fair market value of any property (owned by the covered employee without restriction) that is (or will be) transferred by the covered employee in exchange for the payment.

**Q–20: What is a payment that is contingent on an employee's separation from employment?**

A–20: (a) In general. A payment is contingent on an employee's separation from employment if the facts and circumstances indicate that the employer would not make the payment in the absence of an involuntary separation from employment. A payment, the right to which is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) at the time of an involuntary separation from employment, generally is a payment that would have been made in the absence of a separation from employment (and, thus, is not contingent on a separation from employment), except that the increased value of an accelerated payment of a vested amount described in Q/A–24(b) resulting from an involuntary separation from employment is not treated as a payment that would have been made in the absence of a separation from employment. A payment the right to which is no longer subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) as a result of an involuntary separation from

employment, including a payment the vesting of which would have occurred had the employee remained employed for a subsequent period of time but that is accelerated due to the separation from employment as described in Q/A–24(c), is not treated as a payment that would have been made in the absence of an involuntary separation from employment (and thus is contingent on a separation from employment). A payment would be made in the absence of a separation from employment if it is substantially certain at the time of the separation from employment that the payment would be made whether or not the separation occurred. A payment does not fail to be contingent on a separation from employment merely because the payment is conditioned upon the execution of a release of claims, noncompetition or nondisclosure provisions, or other similar requirements. If an employee separates from service and continues to provide services (including as a bona fide independent contractor), payments for those services are not payments that are contingent on a separation from employment to the extent those payments are reasonable and are not made because of the involuntary separation from employment.

(b) Employment agreements. (1) If a covered employee involuntarily separates from employment before the end of a contract term and is paid damages for breach of contract pursuant to an employment agreement, those damages are treated as a payment that is contingent on a separation from employment. For purposes of this paragraph (b), an employment agreement means an agreement between an employee and employer that describes, among other things, the amount of compensation or remuneration payable to the employee for services performed during the term of the agreement.

(2) The following example illustrates the rules of this Q/A–20(b):

**Example.** A, a covered employee, has a three-year employment agreement with X, an ATEO. Under the agreement, A will receive a salary of \$200,000 for the first year of the agreement, and for each succeeding year, an annual salary that is \$100,000 higher than the previous year. The agreement provides that, in the event of A's involuntary separation from employment without cause, A will receive the remaining salary due under the agreement. At the beginning of the second year of the agreement, X involuntarily terminates A's employment without cause and pays A \$700,000 representing the remaining salary due under the employment agreement (\$300,000 for the second year of the agreement + \$400,000 for the third year of the agreement). The \$700,000 payment is treated as a payment that is contingent on a separation from employment.

(c) Noncompetition agreements. A payment under an agreement requiring a covered employee to refrain from performing services (for example, a covenant not to compete) is a payment that is contingent on a separation from employment for purposes of this Q/A–20 if the payment would not have been made in the absence of an involuntary separation from employment. For example, if a covenant not to compete including one or more payments contingent on compliance in whole or in part with the covenant not to compete is negotiated as part of a severance arrangement arising from an involuntary separation from employment, generally the payment(s) will be treated as contingent on a separation from employment.

(d) Payment of amounts previously included in income or excess remuneration. Actual or constructive payment of an amount that was previously includible in gross income is not a payment contingent on a separation from employment. For example, payment of an amount includible in income under section 457(f)(1)(A) due to the lapsing of a substantial risk of forfeiture on a date before the separation from employment is not a payment that is contingent on a separation from employment, even if the amount is paid in cash or otherwise to the employee because of the separation from employment.

In addition, actual or constructive payment of an amount treated as excess remuneration is not a payment that is contingent on a separation from employment (and thus is not a parachute payment), even if the amount is paid to the employee because of the separation from employment.

(e) Window programs. A payment under a window program is contingent on a separation from employment.

(f) Anti-abuse provision. Notwithstanding the foregoing paragraphs (a) through (e) of this Q/A-20, if the facts and circumstances demonstrate that either vesting or the payment of an amount (whether before or after the involuntary separation from employment) would not have occurred but for the involuntary nature of the separation from employment, the payment of the amount will be treated as contingent on a separation from employment. For example, an employer's exercise of discretion to accelerate vesting of an amount shortly before an involuntary separation from employment may indicate that the acceleration of vesting was due to the involuntary nature of the separation from employment and, thus, was contingent on the employee's separation from employment. Similarly, payment of amount in excess of an amount otherwise payable (for example, increased salary), shortly before or after an involuntary separation from employment, may indicate that the amount was paid because the separation was involuntary and, thus, was contingent on the employee's separation from employment.

**Q-21: What is a payment made under a window program?**

A-21: A window program is a program established by an employer in connection with an impending separation from employment to provide separation pay, where the

program is made available by the employer for a limited period of time (no longer than 12 months) to employees who separate from employment during that period or to employees who separate from service during that period under specified circumstances. A payment made under a window program is treated as a payment that is contingent on an employee's separation from employment notwithstanding that the employee may not have had an involuntary separation from employment.

**Q-22: What is an involuntary separation from employment?**

A-22: An involuntary separation from employment means a separation from employment due to the independent exercise of the employer's unilateral authority to terminate the employee's services, other than due to the employee's implicit or explicit request, if the employee was willing and able to continue performing services. An involuntary separation from employment may include an employer's failure to renew a contract at the time the contract expires, provided that the employee was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing services. The determination of whether a separation from employment is involuntary is based on all the facts and circumstances. An employee's voluntary separation from employment for good reason (as defined in Prop. Treas. Reg. § 1.457-11(d)(2)(ii), 81 FR 40548, 40560) is treated as an involuntary separation from employment

**Q-23: What is a separation from employment?**

A-23: For purposes of section 4960, separation from employment generally has the same meaning as separation from service as defined in Treas. Reg. § 1.409A-1(h), without regard to Treas. Reg. § 1.409A-1(h)(2) and (5) (application to independent

contractors), since generally only an employee may have a separation from employment and a change from employee status to bona fide independent contractor status would also be a separation from employment. See Q/A–12(d) regarding the treatment of an employee who also serves as a director (or in a substantially similar position). In addition, the definition of termination of employment in Treas. Reg. § 1.409A-1(h)(1)(ii) is modified such that an employer may not set the level of the anticipated reduction in future services that will give rise to a separation from employment and that the defaults set forth in the regulations apply. Thus, an anticipated reduction of the level of service of less than 50 percent is not treated as a separation from employment, an anticipated reduction of more than 80 percent is treated as a termination of employment, and the treatment of an anticipated reduction between those two levels is determined based on the facts and circumstances. Pursuant to Treas. Reg. § 1.409A-1(h), an employee generally separates from employment with the employer if the employee dies, retires, or otherwise has a termination of employment with the employer. Treas. Reg. § 1.409A-1(h) provides additional rules addressing leaves of absence, including military leaves of absence (Treas. Reg. § 1.409A-1(h)(1)(i)), asset purchase transactions (Treas. Reg. § 1.409A-1(h)(4)), and employees participating in collectively bargained plans covering multiple employers (Treas. Reg. § 1.409A-1(h)(6)). This notice adopts the rules provided in Treas. Reg. § 1.409A-1(h)(3), under which an employee separates from employment only if the employee has a separation from employment with the employer and all employers that would be considered a single employer under section 414(b) and (c), except that for purposes of section 4960, this notice uses the “at least 80 percent” rule

under section 414(b) and (c) rather than replacing it with “at least 50 percent.” However, for purposes of determining whether there has been a separation from employment, a purported ongoing employment relationship between a covered employee and an ATEO or a related organization will be disregarded if the facts and circumstances demonstrate that the purported employment relationship is not bona fide or the primary purpose of the establishment or continuation of the relationship is avoidance of the application of section 4960.

**Q–24: How is an accelerated payment or accelerated vesting resulting from an involuntary separation from employment treated?**

A–24: (a) In general. As described in Q/A–24(b) and (c), if a payment is accelerated or a substantial risk of forfeiture lapses as a result of an involuntary separation from employment, only the value due to the acceleration is treated as contingent on a separation from employment. For purposes of this Q/A–24, the terms “vested” and “substantial risk of forfeiture” have the same meaning as provided in Q/A–13(a).

(b) Vested payments. If an involuntary separation from employment accelerates actual or constructive payment of an amount that vested without regard to the separation, the portion of the payment, if any, that is contingent on the separation from employment is the amount by which the present value of the accelerated payment exceeds the present value of the payment absent the acceleration. For this purpose, the payment of an amount otherwise due upon a separation from employment (whether voluntary or involuntary) is not treated as an acceleration of the payment because the payment timing was not accelerated due to the involuntary nature of the separation from employment. If the value of the payment absent the acceleration is not reasonably ascertainable, and the acceleration of the payment does not significantly increase the

present value of the payment absent the acceleration, the present value of the payment absent the acceleration is the amount of the accelerated payment (so the amount contingent on the separation from employment is zero). If the present value of the payment absent the acceleration is not reasonably ascertainable, but the acceleration significantly increases the present value of the payment, the future value of the payment contingent on the separation from employment is treated as equal to the amount of the accelerated payment. For this purpose, the acceleration of a payment by 90 days or less is not treated as significantly increasing the present value of the payment. For rules on determining present value, see Q/A–24(f) and Q/A–26 through Q/A–28.

(c) Nonvested payments subject to a vesting service condition--(1) If–

(A) a payment vests as a result of an involuntary separation from employment;

(B) disregarding the separation from employment, the payment was contingent only on the continued performance of services for the employer for a specified period of time; and

(C) the payment is attributable, at least in part, to the performance of services before the date the payment is made or becomes certain to be made;

then the portion that is contingent on the separation from employment is the amount described in Q/A–24(b), plus the value of the lapse of the obligation to continue to perform services described in paragraph (c)(3). The portion of the payment that is contingent on the separation from employment under this Q/A–24(c) cannot exceed the amount of the accelerated payment, or, if the payment is not accelerated, the present value of the payment.

(2) For purposes of paragraph Q/A–24(b), the acceleration of the vesting of a stock option or the lapse of a restriction on restricted stock is considered to significantly increase the value of a payment.

(3) The value of the lapse of the obligation to continue to perform services (described in Q/A–24(c)(1)) is one percent of the amount of the accelerated payment multiplied by the number of full months between the date that the employee’s right to receive the payment is vested and the date that, absent the acceleration, the payment would have been vested. This paragraph (c)(3) applies to the accelerated vesting of a payment in the nature of compensation even if the time when the payment is made is not accelerated. In that case, the amount reflecting the lapse of the obligation to continue to perform services is one percent of the present value of the future payment multiplied by the number of full months between the date that the individual's right to receive the payment is vested and the date that, absent the acceleration, the payment would have been vested.

(d) Nonvested payments subject to a vesting condition other than a service condition. Neither Q/A–24(b) nor (c) applies to a payment if (without regard to the separation from employment) vesting of the payment depends on an event other than the performance of services, such as the attainment of a performance goal, and the vesting event does not occur prior to the separation from employment. For example, neither Q/A-24(b) nor (c) apply if the payment not only vests due to the involuntary separation from employment (despite not having met a separate alternative vesting condition other than the continued performance of services) but the payment also is accelerated due to the involuntary separation from employment. In these

circumstances, the full amount of the accelerated payment is treated as contingent on the separation from employment under this Q/A–24(d).

(e) Application to benefits under a nonqualified deferred compensation plan. In the case of a payment of benefits under a nonqualified deferred compensation plan, Q/A–24(b) applies to the extent benefits under the plan are vested without regard to the separation from employment but the payment of benefits is accelerated due to the involuntary separation from employment. Q/A–24(c) applies to the extent benefits under the plan become vested as a result of the separation from employment and are attributable, at least in part, to the performance of services prior to vesting. For any other payment of benefits under a nonqualified deferred compensation plan (such as a contribution made due to the employee’s involuntary separation from employment) the full amount of the payment is contingent on the employee’s separation from employment.

(f) Present value. For purposes of this Q/A–24, if an accelerated payment is made, the increase in the present value of the payment due under the original payment schedule is determined based on the date on which the accelerated payment is made. The amount that is treated as contingent on the separation from employment is the amount by which the present value of the accelerated payment exceeds the present value of the payment absent the acceleration.

(g) Examples. See Treas. Reg. § 1.280G, Q/A–24(f) for examples that may be applied by analogy to illustrate the rules of this Q/A–24.

### **G. Three-Times-Base-Amount Test for Parachute Payments**

**Q-25: Are all payments that are in the nature of compensation, made to a covered employee, and contingent on a separation from employment, parachute payments?**

A-25: (a) In general. To determine whether payments in the nature of compensation made to a covered employee that are contingent on the covered employee separating from employment with the ATEO are parachute payments, they must be compared to the individual's base amount. To do this, the aggregate present value of all payments in the nature of compensation that are made or to be made to (or for the benefit of) the same covered employee by an ATEO (or any predecessor of the ATEO) or related organization and that are contingent on the separation from employment must be determined. If this aggregate present value equals or exceeds the amount equal to three times the individual's base amount, the payments are parachute payments. If this aggregate present value is less than the amount equal to three times the individual's base amount, no portion of the payments is a parachute payment. See Q/A-26 and Q/A-27 for rules on determining present value.

(b) Examples. The following examples illustrate the rules of this Q/A-25:

**Example 1.** A is a covered employee with respect to M, an ATEO. A's base amount is \$200,000. Payments in the nature of compensation that are contingent on a separation from employment totaling \$800,000 are made to A on the date of the separation from employment. The payments are parachute payments because they have an aggregate present value at least equal to three times A's base amount of \$200,000 ( $3 \times \$200,000 = \$600,000$ ).

**Example 2.** Assume the same facts as in **Example 1**, except that the payments contingent on the separation from employment total \$580,000. Because the payments do not have an aggregate present value at least equal to three times A's base amount, no portion of the payments is a parachute payment.

**Q–26: As of what date is the present value of a payment determined?**

A–26: (a) In general. Except as otherwise provided in this Q/A–26, for purposes of determining if a parachute payment exceeds three times the base amount, the present value of a payment is determined as of the date of the separation from employment, or, if the payment is made prior to that date, the date on which the payment is made.

(b) Deferred payments. For purposes of determining whether a payment is a parachute payment, if a payment in the nature of compensation is the right to receive payments in a year (or years) subsequent to the year of the separation from employment, the value of the payment is the present value of the payment (or payments) calculated on the basis of reasonable actuarial assumptions and using the applicable discount rate for the present value calculation that is determined in accordance with Q/A–27.

(c) Health care. If the payment in the nature of compensation is an obligation to provide health care (including an obligation to purchase or provide health insurance), then for purposes of this Q/A–26 and for applying the three-times-base-amount test under Q/A–25, the present value of the obligation should be calculated in accordance with generally accepted accounting principles. For purposes of Q/A–25 and this Q/A–26, the obligation to provide health care is permitted to be measured by projecting the cost of premiums for health care insurance, even if no health care insurance is actually purchased. If the obligation to provide health care is made in coordination with a health care plan that the employer makes available to a group, then the premiums used for this purpose may be the allocable portion of group premiums.

**Q-27: What discount rate is used to determine present value?**

A-27: For purposes of computing the excise tax under section 4960(a)(2), present value generally is determined by using a discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d) and the regulations thereunder) compounded semiannually. The applicable Federal rate to be used is the Federal rate that is in effect on the date as of which the present value is determined, using the period until the payment is expected to be made as the term of the debt instrument under section 1274(d). See Q/A-26. However, for any payment, the employer and the covered employee may elect to use the applicable Federal rate that is in effect on the date that the contract that provides for the payment is entered into, if that election is made in the contract.

**Q-28: If the present value of a payment to be made in the future is contingent on an uncertain future event or condition, how is the present value of the payment determined?**

A-28: (a) Treatment based on the estimated probability of payment. In certain cases, it may be necessary to apply the three-times-base-amount test or to allocate a portion of the base amount to a payment that is contingent on separation from employment at a time when the aggregate present value of all the payments is uncertain because the time, amount, or right to receive one or more of the payments is also contingent on the occurrence of an uncertain future event or condition. In that case, the employer must reasonably estimate whether it will make the payment. If the employer reasonably estimates there is a 50-percent or greater probability that it will make the payment, the full amount of the payment is considered for purposes of the three-times-base-amount test and the allocation of the base amount. If the employer reasonably estimates there

is a less than 50-percent probability that the payment will be made, the payment is not considered for either purpose.

(b) Correction of incorrect estimates. If the ATEO later determines that the estimate made under Q/A–28(a) was incorrect, it must reapply the three-times-base-amount test described in Q/A–25 (and, if necessary, reallocate the portion of the base amount allocated to previous payments in accordance with Q/A–32) to reflect the actual time and amount of the payment. In reapplying the three-times-base-amount test (and, if necessary, reallocating the base amount), the ATEO must determine the aggregate present value of payments paid or to be paid as of the date described in Q/A–26, using the discount rate described in Q/A–27. This redetermination may affect the amount of any excess parachute payment for a prior taxable year. However, if, based on the application of the three-times-base-amount test without regard to the payment described in this Q/A-28, an ATEO has determined it will pay an employee an excess parachute payment or payments, then the three-times-base-amount test does not have to be reapplied when a payment described in this Q/A-28 is made (or becomes certain to be made) if no base amount is allocated to such payment.

(c) Initial option value estimate. To the extent provided in published guidance of general applicability under § 601.601(d)(2) of this Chapter, an initial estimate of the value of an option subject to Q/A–19(c) is permitted to be made, with the valuation subsequently redetermined, and the three-times-base-amount test reapplied. Until such guidance is published, the guidance under section 280G applies by analogy.

(d) Examples. See Treas. Reg. § 1.280G-1, Q/A–33(d), for examples that may be applied by analogy to illustrate the rules of this Q/A–28.

**Q–29: What is the base amount for purposes of section 4960(c)(5)(D)?**

A–29: (a) In general. A covered employee's base amount is the average annual compensation for services performed as an employee of the ATEO (including compensation for services performed for a predecessor entity of the ATEO), or a related organization with respect to which there has been a separation from employment, if the compensation was includible in the gross income of the individual for taxable years in the base period (including amounts that were excluded under section 911), or would have been includible in the individual's gross income if the individual had been a United States citizen or resident. See Q/A–30 for the definition of base period and for examples of base amount computations.

(b) Short or incomplete taxable years. If the base period of a covered employee includes a short taxable year or less than all of a taxable year of the employee, compensation for the short or incomplete taxable year must be annualized before determining the average annual compensation for the base period. In annualizing compensation, the frequency with which payments are expected to be made over an annual period must be taken into account. Thus, any amount of compensation for a short or incomplete taxable year that represents a payment that will not be made more often than once per year is not annualized.

(c) Excludable fringe benefits. Because the base amount includes only compensation that is includible in gross income, the base amount does not include certain items that constitute parachute payments. For example, payments in the form of excludible fringe benefits or excludible health care benefits are not included in the base amount but may be treated as parachute payments.

(d) Section 83(b) income. The base amount includes the amount of compensation included in income under section 83(b) during the base period.

**Q–30: What is the base period?**

A–30: (a) In general. The base period of a covered employee is the covered employee's five most recent taxable years ending before the date on which the separation from employment occurs. However, if the covered employee was not an employee of the ATEO for this entire five-year period, the individual's base period is the portion of the five-year period during which the covered employee performed services for the ATEO, a predecessor entity, or a related organization.

(b) Examples. The following examples illustrate the rules of Q/A–29 and this Q/A–30:

**Example 1.** C, a covered employee, receives an annual salary of \$500,000 per year during the base period. C defers \$100,000 of salary each year under a nonqualified deferred compensation plan (none of which is includible in C's income until paid). C's base amount is \$400,000  $((\$400,000 \times 5) / 5)$ .

**Example 2.** D, a covered employee, was employed by an ATEO for two years and four months preceding the year in which D separates from employment. D's compensation includible in gross income was \$100,000 for the four-month period, \$420,000 for the first full year, and \$450,000 for the second full year. D's base amount is \$390,000  $((3 \times \$100,000) + \$420,000 + \$450,000) / 3$ .

**Example 3.** Assume the same facts as in **Example 2**, except that D also received a \$60,000 signing bonus when D's employment with the ATEO commenced at the beginning of the four-month period. D's base amount is \$410,000  $((\$60,000 + (3 \times \$100,000)) + \$420,000 + \$450,000) / 3$ . Since the bonus is a payment that will not be paid more often than once per year, the bonus is not taken into account in annualizing D's compensation for the four-month period.

**Example 4.** E, a covered employee with respect to ATEO X, was not an employee of X for the full five-year base period. In 2024 and 2025, E is a director of X and receives \$30,000 per year for E's services. On January 1, 2026, E becomes an officer and covered employee of X. E's includible compensation for services as an officer of X is \$250,000 for each of 2026 and 2027, and \$300,000 for 2028. In 2028, E separates from employment. E's base amount is \$250,000  $((2 \times \$250,000) / 2)$ . The \$300,000

salary paid in 2028 does not affect the base amount because it was paid in the year of separation.

**Q-31: How is the base amount determined in the case of a covered employee who did not perform services for the applicable tax-exempt organization (or a predecessor entity or a related organization), prior to the calendar year in which the separation from employment with the applicable tax-exempt organization occurred?**

A-31: (a) In general. In that case, the covered employee's base amount is the annualized compensation for services performed for the ATEO (or a predecessor entity or related organization) that—

(1) was includible in the employee's gross income for that portion of the employee's taxable year prior to the employee's separation from employment (including amounts that were excluded under section 911), or would have been includible in the employee's gross income if the employee had been a United States citizen or resident; and

(2) was not contingent on the separation from employment.

(b) Examples. The following examples illustrate the rules of this Q/A-31:

**Example 1.** On January 1, 2026, A, a covered employee, enters into a four-year employment contract with ATEO M as an officer of the organization. A did not previously perform services for M (or any predecessor entity or related organization). Under the employment contract, A is to receive an annual salary of \$420,000 for each of the four years that A remains employed by M, with any remaining unpaid balance to be paid immediately in the event that A's employment is terminated without cause. On July 1, 2026, after A has worked six months and received compensation of \$210,000, A's employment is involuntarily terminated without cause, and A receives a payment of \$1,470,000. The payment of \$1,470,000 is contingent on A's separation from employment from M. In this case, A's base amount is \$420,000 (2 x \$210,000). Since the present value of the payment that is contingent on A's separation from employment with M (\$1,470,000) is more than three times A's base amount of \$420,000 (3 x \$420,000 = \$1,260,000), the payment is a parachute payment.

**Example 2.** Assume the same facts as in **Example 1**, except that A also receives a signing bonus of \$500,000 from M on January 1, 2026. The bonus is not contingent on A's separation from employment with M. When A's separation occurs on July 1, 2026,

A has received compensation of \$710,000 (the \$500,000 bonus + \$210,000 in salary). A's base amount is \$940,000 (\$500,000 + (2 x \$210,000)). Because the \$500,000 bonus will not be paid more than once per year, the amount of the bonus is not taken into account in annualizing A's compensation. The present value of the potential parachute payment (\$1,470,000) is less than three times A's base amount of \$940,000 (3 x \$940,000 = \$2,820,000), and therefore no portion of the payment is a parachute payment.

#### **H. Computation of Excess Parachute Payments**

##### **Q-32: How is the amount of an excess parachute payment computed?**

A-32: (a) Calculation. The amount of an excess parachute payment is the excess of the amount of any parachute payment made by an ATEO (or related organization or predecessor organization) over the portion of the covered employee's base amount that is allocated to the payment. For this purpose, the portion of the base amount allocated to any parachute payment is the amount that bears the same ratio to the base amount as the present value of the parachute payment bears to the aggregate present value of all parachute payments made or to be made to (or for the benefit of) the same covered employee. Thus, the portion of the base amount allocated to any parachute payment is determined by multiplying the base amount by a fraction, the numerator of which is the present value of the parachute payment and the denominator of which is the aggregate present value of all parachute payments.

(b) Examples. The following examples illustrate the rules of this Q/A-32:

**Example 1.** E is a covered employee of ATEO X and an employee of related organization Y. E's base amount is \$200,000 with respect to X and \$400,000 with respect to Y. E receives \$1 million from X and \$1 million from Y contingent upon E's involuntary separation from employment from X and Y. For purposes of determining the excise tax under section 4960(a)(2), E has a base amount of \$600,000 (\$200,000 + \$400,000). The two \$1 million payments are parachute payments because their aggregate present value is at least three times E's base amount (3 x \$600,000 = \$1.8 million). The portion of the base amount allocated to each parachute payment is \$300,000 ((\$1 million / \$2 million) x \$600,000). Thus, the amount of each excess parachute payment is \$700,000 (\$1 million - \$300,000).

**Example 2.** A covered employee with a base amount of \$200,000 is entitled to receive two parachute payments, one of \$200,000 and the other of \$900,000. The \$200,000 payment is made upon separation from employment, and the \$900,000 payment is to be made on a date in a future taxable year. The present value of the \$900,000 payment is \$800,000 as of the date of the separation from employment. The portions of the base amount allocated to these payments are \$40,000  $((\$200,000 / \$1 \text{ million}) \times \$200,000)$  and \$160,000  $((\$800,000 / \$1 \text{ million}) \times \$200,000)$ , respectively. Thus, the amount of the first excess parachute payment is \$160,000  $(\$200,000 - \$40,000)$  and that of the second is \$740,000  $(\$900,000 - \$160,000)$ .

#### **I. Reporting Liability Under Section 4960**

#### **Q–33: How do applicable tax-exempt organizations or related organizations report and pay the excise tax imposed under section 4960?**

A–33: (a) In general. Taxes imposed under section 4960 are reported and paid using Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. See also Prop. Treas. Reg. §§ 53.6011-1 and 54.6071-1, 83 F.R. 55653. In any case in which remuneration from a related organization is included to determine the excise tax imposed by section 4960, each ATEO and related organization (including a related taxable organization) must file a separate Form 4720 to report its share of liability. ATEOs and related organizations that are not liable for excise tax under section 4960 for the taxable year need not file Form 4720 for the taxable year unless filing is required under other provisions of the Code or regulations.

(b) Examples. The following examples illustrate the rules of this Q/A–33:

**Example 1.** P, an ATEO, pays \$250,000 of remuneration to Employee A for the taxable year for services performed as a common-law employee of P. A is a covered employee of P and is a highly-compensated employee within the meaning of section 414(q) for the taxable year. P also pays A an excess parachute payment of \$550,000 for the taxable year. Q is a for-profit entity that is a related organization with respect to P. P and Q both use a calendar year taxable year. Q pays A \$1 million of remuneration for the taxable year for services rendered as a common-law employee of Q, and pays no other remuneration to or parachute payment to any covered employee of P.

P and Q must report their respective liabilities for the excise tax for the taxable year on separate Forms 4720. P must report liability for the \$50,000 of excess remuneration it

paid to A ( $(\$250,000 / \$1.25 \text{ million}) \times \$250,000$ ) and the \$550,000 excess parachute payment it paid to A. Even though Q has no covered employees because it is not an ATEO, Q must report liability for the \$200,000 of excess remuneration it paid to A ( $(\$1 \text{ million} / \$1.25 \text{ million}) \times \$250,000$ ) as a related organization of P.

**Example 2.** R, an ATEO, pays \$25,000 of remuneration each to five employees (the highest-compensated group) for each of the taxable year and the preceding taxable year for services performed as common-law employees of R and pays less than \$10,000 of remuneration each to all other employees for each of the taxable year and the preceding taxable year. The amount described in section 414(q)(1)(A), adjusted for inflation for the taxable year, is \$125,000. In addition, for the taxable year, R pays B, a member of the highest-compensated group, an \$80,000 payment in the nature of compensation that was contingent on B involuntarily separating from employment and that exceeds three times B's base amount.

R is not liable for tax under section 4960 and therefore does not need to file a Form 4720 for the taxable year (assuming R is not liable for excise tax under a provision other than section 4960). R paid no excess remuneration for the taxable year because it did not pay any employee remuneration in excess of \$1 million. R paid no excess parachute payment for the taxable year, even though B received a parachute payment that was more than three times the base amount, because B (who received \$105,000 of remuneration in the year of the separation from employment) is not a highly-compensated employee within the meaning of section 414(q).

#### **Q-34: When is the excise tax imposed under section 4960 due?**

A-34: (a) In general. The section 4960 excise tax must be paid and reported by filing Form 4720 by the 15th day of the 5th month after the end of the employer's taxable year. An employer may file Form 8868, Application for Automatic Extension of Time to File an Exempt Organization Return, to request an automatic extension of time to file Form 4720. The automatic extension will be granted if Form 8868 is properly completed, and timely filed. Form 8868 does not extend the time to pay tax. To avoid interest and penalties, an employer must pay the tax due by the original due date of Form 4720.

(b) Election to prepay tax. Notwithstanding the general rule described in Q/A-2 and Q/A-34(a), an employer may prepay the excise tax under section 4960(a)(2) for the

taxable year of the separation from employment or any later taxable year before the taxable year for which the parachute payment is actually or constructively paid (see Q/A–2). (However, an employer may not prepay the excise tax on a payment to be made in cash if the present value of the payment is not reasonably ascertainable under section 3121(v)(2) and Treas. Reg. § 31.3121(v)(2)-1(e)(4) or on a payment related to health coverage.) Any prepayment must be based on the present value of the excise tax that would be due for the taxable year for which the employer will pay the excess parachute payment, and be calculated using the discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d) and regulations thereunder; see Q/A–27) and the tax rate in effect under section 11 for the year in which the excise tax is paid. For purposes of projecting the future value of a payment that provides for interest to be credited at a variable interest rate, the employer may make a reasonable assumption regarding the variable rate. An employer is not required to adjust the excise tax paid under this Q/A–34(b) merely because the actual future interest rates are not the same as the rate used for purposes of projecting the future value of the payment.

(c) Example. The following example illustrates the rules of this Q/A–34:

**Example.** A covered employee with a base amount of \$200,000 is entitled to receive two parachute payments, one of \$200,000 and the other of \$900,000. The \$200,000 payment is made upon separation from employment, and the \$900,000 payment is to be made on a date in a future taxable year. The present value of the \$900,000 payment is \$800,000 as of the date of the separation from employment. The employer elects to prepay the excise tax on the \$900,000 future parachute payment (of which \$740,000 is an excess parachute payment). The tax rate under section 11 is 21 percent for the taxable year the excise tax is paid and, using a discount rate determined under Q/A–27, the present value of the \$155,400 ( $\$740,000 \times 21$  percent) excise tax on the \$740,000 future excess parachute payment is \$140,000. To prepay the excise tax on the \$740,000 future excess parachute payment, the employer must satisfy its \$140,000 obligation under section 4960 with respect to the future payment, in addition to the

\$33,600 excise tax (\$160,000 x 21 percent) on the \$160,000 excess parachute payment made upon separation from employment. For purposes of determining the amount of excess remuneration (if any) under Q/A–11, the amount of remuneration paid by the employer to the covered employee for the taxable year of the separation from employment is reduced by the \$900,000 of total excess parachute payments (\$160,000 + \$740,000).

**Q–35: Are applicable tax-exempt organizations or related organizations required to pay estimated taxes for the excise tax imposed under section 4960?**

A–35: No. There is no requirement under section 6655 for ATEOs or related organizations to pay estimated taxes on excise taxes imposed under section 4960. Instead, the excise tax is reported and paid annually on Form 4720.

**J. Miscellaneous Issues**

**Q–36: Does the payment of remuneration subject to excise tax under section 4960 automatically constitute an excess benefit transaction under section 4958?**

A–36: No, the imposition of excise tax under section 4960 is not determinative as to whether the remuneration paid to the covered employee is excessive or unreasonable compensation for purposes of section 4958. Similarly, there is no presumption, inference, or basis for concluding that remuneration paid to a covered employee that is not subject to excise tax under section 4960 is reasonable compensation for purposes of determining liability for excise tax under section 4958.

**Q–37: Does the payment of remuneration subject to excise tax under section 4960 necessarily constitute an act of self-dealing described in section 4941?**

A–37: No, if the covered employee is a disqualified person described in section 4946, the imposition of excise tax under section 4960 is not determinative as to whether the remuneration paid to the covered employee is excessive or unreasonable compensation for purposes of section 4941. Similarly, there is no presumption, inference, or basis for concluding that remuneration paid to a covered employee that is not subject to excise

tax under section 4960 is reasonable compensation for purposes of determining excise tax under section 4941.

**Q–38: Does section 4960 apply to amounts to which section 162(m) applies?**

A–38: (a) In general. Remuneration paid by a publicly held corporation within the meaning of section 162(m)(2) to a covered employee within the meaning of section 162(m)(3) generally is taken into account for purposes of section 4960. Similarly, remuneration paid by a covered health insurance provider within the meaning of section 162(m)(6)(C) to an applicable individual within the meaning of section 162(m)(6)(F) generally is taken into account for purposes of section 4960. However, any amount of remuneration for which a deduction is not allowed by reason of section 162(m) is not taken into account for purposes of section 4960.

(b) Example. The following example illustrates the rules of this Q/A–38:

**Example.** Employee A is an officer of Corporation X. Corporation X is a related organization as described in Q/A–7 with respect to an ATEO. A is also a covered employee of the ATEO. A receives compensation of \$1.5 million from X, of which \$500,000 is nondeductible by reason of section 162(m)(1). The amount of deduction disallowed under section 162(m) (\$500,000) is not treated as remuneration for purposes of section 4960. However, the remuneration paid by X that is not disallowed by reason of section 162(m)(1) (\$1 million) is treated as remuneration for section 4960 purposes.

**K. Effective Date**

**Q–39: What is the effective date of section 4960?**

A–39: (a) In general. Section 4960 applies to taxable years of an employer beginning after December 31, 2017. Remuneration paid before the beginning of the first taxable year that begins after December 31, 2017, is not subject to the excise tax under section 4960.

(b) Examples. The following examples illustrate the rules of this Q/A–39:

**Example 1.** ATEO X uses a calendar year taxable year. ATEO Y is a related organization with respect to X and uses a taxable year beginning July 1 and ending June 30. X and Y each pay covered employee L \$1.2 million of remuneration in calendar year 2018 (\$2.4 million total) in equal monthly amounts.

X and Y's liability under section 4960(a)(1) is determined by taking into account only remuneration paid during their respective taxable years beginning after December 31, 2017. X pays L a total of \$1.2 million in remuneration during X's first taxable year beginning after December 31, 2017 (January 1, 2018 through December 31, 2018). Y pays L \$600,000 during the portion of the calendar year ending with or within Y's first taxable year beginning after December 31, 2017 (July 1, 2018 through December 31, 2018), resulting in \$800,000 (\$1.2 million + \$600,000 - \$1 million) of excess remuneration paid in calendar year 2018.

**Example 2.** ATEO Z uses a calendar year taxable year. On January 1, 2017, Z credits \$1 million of remuneration to an account under a nonqualified account balance plan on behalf of covered employee M. Under the plan, M will not vest in the amount unless M performs substantial services through December 31, 2018. On December 31, 2017, the account balance is \$1.1 million. On December 31, 2018, the account balance is \$1.2 million. Although M's account balance as of December 31, 2017 was \$1.1 million, the entire \$1.2 million is treated as remuneration paid in calendar year 2018, because vesting did not occur until December 31, 2018. If instead the \$1.1 million had vested during 2017, only the \$100,000 increase in the account balance during 2018 would have been treated as remuneration paid in 2018 potentially subject to the excise tax under section 4960(a)(1).

### III. REQUEST FOR COMMENTS

The Treasury Department and the IRS intend to issue proposed regulations with respect to section 4960. The Treasury Department and the IRS request comments on the topics addressed in this notice and any other issues arising under section 4960. The Treasury Department and the IRS specifically request comments regarding the following topics:

(1) Whether, for purposes of determining whether an employee is a covered employee, calculating remuneration, and calculating excess parachute payments, an employer should be permitted to rely on the employee's written representation that the

employee did not perform services for any other employer during the calendar year ending with or within the ATEO's taxable year (or did not perform services for one or more specified employers). If so, whether there are circumstances (for example, an employer has reason to know that the written representation was incorrect) under which an employer should not be permitted to rely on such a representation, and in what manner such a written representation must be documented in order to be relied upon.

(2) Whether, for purposes of calculating remuneration from a related organization with a change in status as a related organization during the year, there should be an alternative to calculating the actual amount paid while the employer was a related organization with respect to the ATEO and, if so, what alternative(s) should be available that would continue to provide a useful calculation with respect to both the ATEO and the related organizations without creating opportunities for abusive reallocations of remuneration among the related organizations.

(3) How remuneration based on the appreciation and depreciation of the fair market value of the stock underlying stock options and stock appreciation rights (or other similar equity rights) should be taken into account.

(4) How a related organization should treat remuneration on which it was subject to excise tax under section 4960 in a prior taxable year and for which it is denied a deduction under section 162(m) in the current taxable year.

(5) How the term "predecessor" should be defined for purposes of defining covered employees.

(6) How remuneration paid to medical service providers should be reasonably allocated between medical services and other services, including how reasonable

allocations can be made taking into account comparable salaries, time spent performing medical services and other services, and any applicable employment agreements.

All materials submitted will be available for public inspection and copying. Public comments should be submitted no later than April 2, 2019. Comments should include a reference to Notice 2019-09. Comments may be submitted electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (type IRS-2019-0001 in the search field on the **regulations.gov** homepage to find this notice and submit comments). Alternatively, submissions may be sent to CC:PA:LPD:PR (Notice 2019-09), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2019-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. All recommendations for guidance submitted by the public in response to this notice will be available for public inspection and copying in their entirety.

#### IV. RELIANCE

The Treasury Department and the IRS intend to issue further guidance regarding section 4960 in the form of proposed regulations. Until further guidance is issued, taxpayers may rely on the rules in this notice for purposes of section 4960 effective from December 22, 2017 (the date of enactment). Further guidance will be prospective and will not apply to taxable years beginning before the issuance of such guidance.

## V. PAPERWORK REDUCTION ACT

The collection of information in this notice is the requirement under section 4960 that an ATEO determine and keep records of its covered employees, related organizations, and excess remuneration and excess parachute payments paid to covered employees by the ATEO and related organizations, disclose this information to each related organization, and that each ATEO and related organization report excise tax liability to the IRS. The collection of information contained in this notice is reflected in the collection of information for Form 4720 that has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545-0052.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

## VI. DRAFTING INFORMATION

The principal authors of this notice are William McNally and Chelsea Rubin of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For Executive Compensation questions, contact Mr. McNally at (202) 317-5600 (not a toll-free number). For Exempt Organizations questions, contact Ms. Rubin at (202) 317-5800 (not a toll-free number).