September 29, 2020

Mr. William McNally
Associate Chief Counsel
Office of Chief Counsel
Employee Benefits, Exempt Organizations,
and Employment Taxes
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Re: Proposed Regulations on Excise Tax Imposed under Section 4960, Excess Remuneration

Dear Mr. McNally:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to address the need for guidance related to new section 4960,[1] which was added to the Internal Revenue Code (IRC) by Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA), related to the excise tax on executive compensation paid by tax-exempt organizations.

On June 11, 2020, Treasury and the IRS issued REG-122345-18 ("proposed regulations") concerning the excise tax imposed regarding excess tax-exempt organization executive compensation. On December 31, 2018, Treasury and the IRS issued Notice 2019-09 – Interim Guidance on Excise Tax Imposed under Section 4960, Excess Remuneration (the "Notice"). The AICPA previously commented on Notice 2019-09.[2] This letter is in response to the request by Treasury and the IRS for comments on the rules described in the proposed regulations.

Specifically, the AICPA recommends that Treasury and the IRS provide guidance on the following issues related to the new section 4960:

I. Filing Returns and Payment of Tax by Related Organizations

II. Short-term Deferral Exception

[1] All references to "section" or "§" are to the Internal Revenue Code of 1986, as amended, and all references to "Treas. Reg. §" and "regulations" are to U.S. Treasury regulations promulgated thereunder.
[2] AICPA comment letter on Notice 2019-09 – Interim Guidance on Excise Tax Imposed under Section 4960, Excess Remuneration https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20200219-aicpa-comments-section-4960.pdf (February 19, 2020).

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Deborah Walker, Chair, AICPA Employee Benefits Taxation Technical Resource Panel, at (202) 257-5609, or dwalker@cbh.com; Jennifer Becker Harris, Chair, AICPA Exempt Organizations Taxation Technical Resource Panel at (425) 454-4919, or jharris@clarknuber.com; Elizabeth Young, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9247, or elizabeth.young@aicpa-cima.com; or me at (612) 397-3071, or chris.hesse@CLAconnect.com.

Sincerely,

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable David J. Kautter, Assistant Secretary for Tax Policy, Department of the Treasury
The Honorable Charles P. Retting, Commissioner, Internal Revenue Service
The Honorable Michael J. Desmond, Chief Counsel, Internal Revenue Service
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
Mr. Thomas West, Tax Legislative Counsel, Department of the Treasury
Ms. Amber Salotto, Attorney Advisor, Department of the Treasury
Ms. Tamera Ripperda, Commissioner, Tax Exempt & Government Entities, Internal Revenue Service
Mr. Edward Killen, Deputy Commissioner, Tax Exempt and Government Entities, Internal Revenue Service
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AMERICAN INSTITUTE OF CPAs

Proposed Regulations on Excise Tax Imposed under Section 4960, Excess Remuneration

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BACKGROUND

Section 4960 imposes a 21-percent excise tax on the sum of:

1. Any remuneration paid (other than an excess parachute payment) by an applicable tax-exempt organization (ATEO) for a taxable year with respect to the employment of any covered employee in excess of $1 million; plus
2. Any excess parachute payment paid by such organization to any covered employee.

The excise tax is imposed on ATEOs and related entities for remuneration in excess of certain amounts received by a covered employee. In general, a covered employee is an employee or former employee who is one of the 5 highest compensated employees of the organization. Once an individual is a covered employee for any taxable year beginning after December 31, 2016, that person remains a covered employee for all future taxable years. This new tax is effective for all taxable years beginning after December 31, 2017.

The guidance in the proposed regulations provides rules regarding the entity liable for the excise tax under section 4960, the determination of remuneration, how the excise tax is calculated, and how taxpayers should report and pay the tax.

SPECIFIC COMMENTS

I. Filing Returns and Payment of Tax by Related Organizations

Overview

In any case in which a covered employee receives remuneration from 2 or more related employers in determining the excise tax, section 4960(c)(4)(C) provides that each employer is liable for tax in an amount which bears the same ratio to the total tax as (1) the amount of remuneration paid by the employer with respect to the covered employee, bears to (2) the total remuneration paid to the covered employee by all of the related employers.

Recommendation

The AICPA recommends that the IRS and Treasury issue proposed regulations allowing an ATEO or a related organization to: (1) file a single excise tax return (Form 4720 – *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*) reporting all of the excess remuneration paid by the filing entity and all the related organizations; and (2) submit a single payment for the total excise tax owed by the filing organization and the related organizations.

The AICPA also recommends requiring the tax-exempt organization to attach a schedule to the Form 4720 identifying any related organizations.

Analysis

Section 4960(c)(4)(C) allocates the liability for tax in the event that excess remuneration is paid to a covered employee by an ATEO and one or more related employers. Absent authorization to file a combined return, the ATEO and each related organization is required to file a separate Form 4720. In addition, many tax-exempt organizations, particularly large health systems, have multiple ATEOs with covered employees. The filing and processing of multiple returns will increase the administrative burden for both taxpayers and the IRS, while not changing the amount of excise taxes that are collected. Allowing related organizations to elect to file a combined return would result in one tax return to process.

For example, assume ATEO 1 and ATEO 2 are related organizations pursuant to section 4960(c)(4)(B). Employee E, a covered employee, received remuneration of $900,000 from ATEO 1 and $600,000 from ATEO 2. Employee E has received $500,000 in excess remuneration ($900,000 + $600,000 - $1,000,000) resulting in an excise tax under section 4960(a) of $105,000.

Under section 4960(c)(4)(C), each employer is liable for its share of the excise tax in the same ratio that the remuneration paid by the employer bears to the total remuneration paid to Employee E. ATEO 1's share of the tax is $63,000 (($900,000/$1,500,000) x $105,000). ATEO 2's share of the tax is $42,000 (($600,000/$1,500,000) x $105,000).

Through the use of a combined filing, ATEO 1 (or ATEO 2) could file a single Form 4720, reporting $500,000 in excess remuneration for Employee E and paying the $105,000 excise tax. The filing of additional returns merely adds administrative complexity while not changing the tax collected by the IRS. In the event of a failure to file Form 4720, or failure to pay the required tax, the liability for the tax in the case of related organizations would still be determined pursuant to section 4960(c)(4)(C).

II. Short-Term Deferral Exception

Overview

The tax under section 4960 is imposed on remuneration. For this purpose, "remuneration" is defined by section 4960(c), and includes amounts that are "wages" within the meaning of section 3401(a). In addition, section 4960(c)(3) provides that remuneration includes amounts that are required to be included in income under section 457(f), an ineligible deferred compensation plan or arrangement. Thus, section 4960(a) taxes two distinct types of remuneration. First, if remuneration is not described in section 457(f) (i.e., it is current compensation), it is taxed when it is paid. Second, if remuneration is described in section 457(f) (i.e., it is deferred compensation), it is taxed when there is no substantial risk of forfeiture of the amounts. Under section 457(f)(3)(B), the rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to the compensation are conditioned upon the future performance of substantial services by any individual.

Generally, this treatment would apply for income tax purposes because section 457(f)(1)(A) requires the inclusion of compensation from ineligible deferred compensation plans of tax-exempt employers for the first taxable year in which there is no substantial risk of forfeiture. However, Prop. Reg. § 1.457-12(d)(2) provides an exception for short-term deferrals defined in Treas. Reg. § 1.409A-1(b)(4). Thus, for purposes of section 457, payments that are actually or constructively received on or before the 15th day of the third month following the end of the year in which there was no longer a substantial risk of forfeiture are not included in gross income until they are actually or constructively received. Despite the exclusion of short-term deferrals from the definition of "deferred compensation" for purposes of section 457(f), the proposed regulations under section 4960 do not follow this rule. Rather, the proposed regulations would tax short-term deferrals in the year of vesting, similar to the treatment provided to amounts that constitute deferred compensation for purposes of section 457(f).

Recommendation

The AICPA recommends that Treasury and the IRS reconsider their position with respect to short-term deferrals, and issue final regulations providing that the short-term deferral exception to the definition of deferred compensation for section 457(f) applies to section 4960 such that the year of inclusion for income tax purposes matches the year of inclusion for section 4960 purposes.

Analysis

The language in section 4960(a) that references the substantial risk of forfeiture provides a timing rule, but only a timing rule. In order to be subject to tax under section 4960, the amounts in question must constitute remuneration. In order for an item to be remuneration for purposes of section 4960 for a year, it must either be wages within the meaning of section 3401(a) for the year, or an amount subject to section 457(f) during the year. If an amount does not satisfy one of these criteria, it is not section 4960 remuneration during the year, and, therefore, not subject to section 4960 for the year.

Section 4960(c)(3)(A) defines remuneration as wages (as defined in section 3401(a)), except that such term shall not include any designated Roth IRA contribution (as defined in section 402A(c)) and shall include amounts required to be included in gross income under section 457(f). Items that meet an exception to the definition of deferral of compensation for purposes of section 457(f) are not included in gross income under section 457(f) (i.e., in the year no longer subject to a substantial risk of forfeiture) for a cash basis taxpayer, even though they are vested. If short-term deferrals were considered deferred compensation that were subject to section 457 and required to be included in gross income under section 457(f), they would be included in the year of vesting rather than the year of payment. However, the IRS provided the short-term deferral exception under the proposed regulations to section 457(f) and allows taxpayers to rely on those proposed regulations until they are issued in final form. Since the definition of remuneration for purposes of section 4960 references items that are included in gross income under section 457(f), inclusion of a short-term deferral exception to the vesting rules is warranted. In addition, unless the IRS reverses the position it has taken in the proposed section 457(f) regulations, we believe a short-term deferral exception is consistent with the statute and the current proposed regulations.

In addition, since the definition of remuneration begins with the compensation subject to income tax withholding, elimination of short-term deferrals from compensation for purposes of section 4960 will eliminate an adjustment to compensation. Most taxpayers calculating remuneration will begin with the amount reported on Form W-2 and adjust for amounts included in income due to the vesting rule. Elimination of as many of these adjustments as reasonable while still properly considering the vesting rule simplifies the calculation of remuneration for taxpayers and, because many of these amounts are similar for each year, does not materially change the amount of remuneration reported.

In the preamble to the proposed regulations, the IRS and Treasury indicated that they were concerned that a short-term deferral rule would permit an ATEO to select the year in which remuneration would be subject to tax under section 4960. We disagree with this overall concern and observe the following:

- There may be situations in which an individual is not a covered employee in one year, and becomes, for the first time, a covered employee in the following year. The lack of a short-term deferral rule would allow any short-term deferral compensation paid in the first year that an individual qualifies as a covered employee to escape taxation under section 4960. In this regard, a short-term deferral rule would work against the interests of the taxpayer.

- The IRS's proposed rule related to section 457(f) adds unnecessary complexity. The approach taken by the regulations with respect to amounts that are subject to section 457(f) is that the vested amount is subject to tax in the year of vesting. In subsequent years, and prior to payment, any earnings that accrue during the year are subject to tax. This cycle repeats until the amount is paid out. If short-term deferrals are subject to tax in the same way, the proposed regulations impose this same requirement and the amount subject to tax in the year of vesting is not the amount paid, but the discounted present value of the payment calculated as of a date in the year of vesting. The remaining amount is subject to tax in the year of payment and creates additional complexity for ATEOs.

- Employers are provided a similar choice with respect to selecting the timing of the FICA taxation of nonqualified deferred compensation. See Treas. Reg. § 31.3121(v)(2)-1(b)(3)(iii). In order to eliminate concerns, the IRS could adopt a rule that requires consistent treatment by an employer with respect to its selection of the timing of FICA taxation of short-term deferrals and treating those amounts as remuneration for purposes of section 4960. This rule could have the added benefit of allowing an employer consistent treatment, avoiding unnecessary separate tracking of items for FICA, W-2 reporting, and section 4960 purposes.