



Tax News & Views

Health Care Edition

Final Regulations on Excise Tax on Executive Compensation

On January 11, 2021, the Treasury Department (“Treasury”) and Internal Revenue Service (IRS) released final regulations (T.D. 9938, the “Final Regulations”) under IRC section 4960, which imposes a 21% excise tax on remuneration paid in excess of \$1 million and any excess parachute payments paid to a covered employee by an applicable tax-exempt organization (ATEO) and any related parties. The Final Regulations were published in the Federal Register on January 19, 2021.

Find it Fast

Final Regulations on Excise Tax on Executive Compensation

Did you know

Congress enacted IRC section 4960 as part of the 2017 Tax Act (P.L. 115-97, known as the Tax Cuts and Jobs Act or "TCJA"). IRC section 4960 applies to taxable years beginning after December 31, 2017. On December 31, 2018, the IRS released Notice 2019-09 (the "Notice") to provide interim guidance on the new provision. Treasury and the IRS released proposed regulations (85 FR 35746, the "Proposed Regulations") on June 5, 2020, which provided definitions of various terms, as well as guidance on identifying covered employees, computing remuneration, determination of excess parachute payments, and calculation of liability for tax. In addition, the Proposed Regulations provided supplementary definitional items, added exceptions for certain related organizations, and clarified other portions of the Notice. The Final Regulations largely adopt the Proposed Regulations with minor changes, as described below.

Definitions

Applicable tax-exempt organization (ATEO) means any of the following:

- IRC section 501(a) organization,
- IRC section 521 farmer's cooperative,
- IRC section 115(1) organization, and
- IRC section 527 political organization.

A foreign organization (defined in IRC section 4948(b)) that receives substantially all (i.e., at least 85%) of its support (other than gross investment income) from the date of its creation from sources outside of the US is not an ATEO. The determination of whether an organization meets this requirement is made at the end of the organization's taxable year. Remuneration paid by foreign organizations may still be considered remuneration from related organizations that are considered ATEOs.

Treasury and the IRS reserved the right to issue further guidance regarding the applicability of IRC section 4960 on federal instrumentalities (described in IRC section 501(c)(1)(A)(i)). Until such time, these organizations may treat themselves as organizations that are not subject to IRC section 4960, but remuneration paid by these organizations may still be considered remuneration from related organizations that are considered ATEOs.

The **applicable year** for calculation of the excise tax means a calendar year ending with or within the ATEO's taxable year. The Final Regulations adopt the guidance in the Proposed Regulations on how to determine an applicable year in situations such as short periods, initial and final tax years, and situations involving termination of ATEO status as a result of the organization no longer qualifying as a tax-exempt organization.

Related organizations under the Final Regulations include the following organizations:

- An organization that controls or is controlled by the ATEO,
- Organizations controlled by the same persons (brother-sister organizations),
- Supported organization of an ATEO,
- Supporting organization of an ATEO, or
- An organization that establishes, maintains, or makes contributions to a voluntary employees' beneficiary association (VEBA).

Foreign organizations and federal instrumentalities, as mentioned above, may also be considered related organizations to an ATEO.

Control for purposes of determining related organizations may be direct or indirect, after applying the attribution rules under IRC section 318. Control for various types of organizations is defined as follows:

- Stock corporation: Ownership (by vote or value) of more than 50% of the stock of the corporation;
- Partnership: Ownership of more than 50% of the profits interest or capital interest of the partnership;
- Trust with beneficial interest; Holding more than 50% of the beneficial interests in the trust; and
- Nonstock organization (including most tax-exempt organizations): More than 50% of the directors or trustees of a nonstock organization are either representatives of, or controlled by, another entity or person that controls the other entity. A representative includes a trustee, director, agent, or employee, and control includes the power to remove a trustee or director and designate a new trustee or director.

A **covered employee** is any individual who is one of the five highest-compensated employees of the ATEO for the taxable year or was a covered employee of the ATEO (or any predecessor organization) for any preceding year starting after December 31, 2016. Once an individual is a covered employee the individual is always a covered employee with respect to the ATEO. The Final Regulations adopt the guidance in the Proposed Regulations on predecessor and successor organizations in the context of acquisitions, mergers or similar transactions.

An **employee** is defined under IRC section 3401(c) and Treas. Reg. § 31.3401(c)-1 as any individual performing services if the relationship between the individual and the person for whom the individual performs services is the legal relationship of employer and employee. This includes common law employees, officers, and government employees. *An officer of a corporation who does not perform any services, or performs only minor services, and who neither receives nor is entitled to receive any remuneration is not considered an employee solely due to their status as an officer of the corporation. A director of a corporation or a trustee of a trust are not considered employees in their capacities as a director or trustee.*

Additional Guidance on Determining Covered Employees

As noted above, a covered employee is any individual who is one of the five highest-compensated employees of the ATEO for the taxable year. In identifying who the covered employees are, remuneration received from the ATEO that employs the individual is considered, along with remuneration received from any related organization.

Observation: *Thus, if an individual receives remuneration from another related organization, that individual may become a covered employee of the ATEO, in the place of another individual who receives remuneration exclusively from the ATEO. For example:*

Assume that the highest-compensated employees of ATEO 1 receive the following amounts of remuneration during 2021:

- Employee A: \$2 million,
- Employee B: \$1.8 million,
- Employee C: \$1.6 million,
- Employee D: \$1.4 million, and
- Employee E: \$1.2 million.

If there are no other related organizations, these individuals would be ATEO 1's covered employees. Now assume that ATEO 1 has a related organization, ATEO 2, and that Employee F receives \$800,000 in remuneration from ATEO 1, and \$700,000 in remuneration from ATEO 2, and that none of the other five employees of ATEO 1 receive any remuneration from ATEO 2. Because ATEO 2 is a related organization to ATEO 1, remuneration paid by ATEO 2 is considered for purposes of determining ATEO 1's covered employees. In this case, Employee F is considered to have \$1.5 million in remuneration, and would be among the five highest compensated employees of ATEO 1, and therefore, a covered employee. As a result of Employee F qualifying as a covered employee of ATEO 1, Employee E is no longer considered one of ATEO 1's five highest compensated employees, and will not be a covered employee for 2021 unless Employee E had qualified as a covered employee of ATEO 1 (or any predecessor of ATEO 1) in a preceding year.

The Final Regulations maintain the exceptions provided in the Proposed Regulations, with minor modifications, to address situations in which an individual is providing substantial services to organizations related to the ATEO for determining an ATEO's five highest-compensated employees. These include the limited hours exception, the nonexempt funds exception, and the limited services exception. If any of these exceptions are met, the individual is not considered one of the five highest-compensated employees of the ATEO (and would not be a covered employee).

The **limited hours exception** applies if the following two criteria are met:

1. Neither the ATEO nor any related ATEO paid remuneration or granted a legally binding right to nonvested remuneration for services performed as an employee of the ATEO, and
2. The individual performed services as an employee of the ATEO and all related ATEOs for no more than 10% of the total hours the individual worked as an employee of the ATEO and all related organizations.

The individual is deemed to meet the 10%-of-total-hours requirement if they did not perform more than 100 hours of service for the ATEO and all related ATEOs during the year.

A payment made by a related organization that is an employer of the individual and which is not reimbursed by the ATEO nor entitled to any other consideration from the ATEO is not deemed paid by the ATEO.

Observation: *The following example illustrates the application of the limited hours exception:*

ATEO 1 and Corp 1 (a for-profit corporation) are related organizations. John Doe is an employee of Corp 1 and serves as an officer of ATEO 1. John works 75 hours a year at ATEO 1 and 1,925 hours for Corp 1 during a year. ATEO 1 does not pay any remuneration nor does it grant a legally binding right to nonvested remuneration to John for services performed for ATEO 1. In addition, the ATEO does not reimburse Corp 1 for any portion of the compensation Corp 1 pays to him.

John Doe meets the limited hours exception since he serves less than 10% of the total hours for the ATEO (3.75%) and the ATEO does not pay remuneration or grant legally binding rights to nonvested remuneration to John the ATEO for any services performed for the ATEO. John Doe also meets the 100-hour safe harbor. John Doe is not considered as part of the top five highest-compensated employees for the year and therefore is not a covered employee.

The **nonexempt funds exception** applies if the following requirements are met:

1. The ATEO, any related ATEO, or related for-profit organization controlled by the ATEO (or by one or more related ATEOs) has not paid, either alone or together with the ATEO, remuneration or granted a legally binding right to nonvested remuneration to an individual for services the individual performed as an employee of the ATEO;
2. The individual performed services as an employee of the ATEO and all related ATEOs for less than 50% of the total hours worked as an employee of the ATEO during the applicable year and preceding applicable year; and
3. No related organization that paid remuneration or granted a legally binding right to nonvested remuneration to the individual provided services for a fee to the ATEO, to any related ATEO, or to any taxable related organization controlled by the ATEO (or by one or more related ATEOs).

A payment made by a related organization that is an employer of the individual and which is not reimbursed by the ATEO nor entitled to any other consideration from the ATEO is not deemed paid by the ATEO.

For the purpose of payment of remuneration, whether a taxable related organization is controlled by the ATEO (or one or more related ATEOs) is determined without regard to IRC section 318(a) (3), so that an interest in a corporation or nonstock entity is not attributed downward in determining control of the corporation or nonstock entity.

Observation: The following example illustrates the application of the nonexempt funds exception:

ATEO 1, ATEO 2 and Corp 1 (a for-profit corporation) are related organizations. Jane Doe is an employee of Corp 1 and serves as an officer of ATEO 1 and ATEO 2. She works 600 hours at ATEO 1, 500 hours at ATEO 2 and 1,000 hours at Corp 1 during the applicable tax year. She worked 700 hours at ATEO 1, 600 hours at ATEO 2 and 1,000 hours at Corp 1 during the preceding applicable year. Jane is the only employee at ATEO 1 and ATEO 2. ATEO 1 and ATEO 2 do not pay any remuneration nor grant a legally binding right to nonvested remuneration for services performed at ATEO 1 or ATEO 2. Additionally, ATEO 1 and ATEO 2 do not pay Corp 1 for any services provided by Jane to ATEO 1 and ATEO 2.

Jane does not meet the non-exempt fund exception, since she spends more than 50% of her time ($2,400/4,400 = 54.5\%$) on ATEO 1 and ATEO 2. Therefore, Jane is one of the top five highest compensated employees and a covered employee of ATEO 1 and ATEO 2.

For both the **limited hours** and **nonexempt funds exceptions**, a percentage of total days may be used to calculate the second prong of the two tests. However, if the taxpayer uses total days to perform the test, any partial day worked for an ATEO is treated as a full day.

The **limited services exception** is only applicable with respect to an ATEO with one or more related ATEOs. This exception applies to an employee even if the ATEO pays compensation to an employee, if the following requirements are met:

1. The ATEO did not pay 10% or more of the employee's total remuneration for services performed as an employee of the ATEO; and
2. The ATEO had at least one related ATEO and one of the following two conditions are met:
 - A. A related ATEO paid at least 10% of the remuneration paid by the ATEO and all related organizations, or
 - B. No related ATEO paid at least 10% of the total remuneration and the ATEO paid less than one related ATEO.

Observation: The following example illustrates the application of the limited services exception:

ATEO 1, ATEO 2, and ATEO 3 are related organizations. John Doe is an employee of ATEO 1, ATEO 2, and ATEO 3. ATEO 1 pays 90% of John Doe's salary and ATEO 2 and ATEO 3 each pay 5% of John Doe's salary.

ATEO 1 does not meet the limited services exception since it pays more than 10% of the total remuneration of John Doe (90%). John Doe may be considered as one of the top five highest-compensated employees of ATEO 1 and could be considered a covered employee.

ATEO 2 and ATEO 3 meet the limited service exception, since ATEO 2 and ATEO 3 both pay less than 10% of John Doe's salary, and a related ATEO paid at least 10% of John Doe's salary. John Doe is not considered as part of the top five highest-compensated employees for the year and therefore not a covered employee with respect to ATEO 2 and ATEO 3.

Determination of remuneration

Under IRC section 4960, an individual's status as a covered employee, as well as the calculation of the excise tax imposed, is determined on the basis of remuneration paid to the individual.

Remuneration means any amount of wages defined under IRC section 3401(a), excluding any designated Roth contributions, and including amounts required to be included in income under IRC section 457(f). Remuneration also includes amounts includible in gross income as compensation for services pursuant to below-market loans but does not include amounts that meet the \$10,000 de minimis exception (IRC section 7872(c)(3)). Director fees are excluded from remuneration as long as the fees are paid to a director who is also an employee, do not exceed the fees paid to a director who is not an employee of the organization or any related organization, and if no nonemployee directors are paid, the amounts are reasonable. Remuneration does not include payments for medical services. For individuals that may perform both medical and nonmedical services, a reasonable allocation is required between the two activities. Remuneration paid by any related organization is generally taken into account in determining remuneration paid by the ATEO. Remuneration does not include any amount that became vested or was paid by a taxpayer before the start of the taxpayer's first taxable year that began on or after January 1, 2018.

Remuneration is treated as paid on the date it is actually or constructively paid, if the remuneration is a **regular wage** within the meaning of Treas. Reg. § 31.3402(g)-1(a)(1)(ii) (a "regular wage"). A regular wage is defined as remuneration paid at a regular hourly, daily, or similar periodic rate (and not an overtime rate) for the current payroll period. The preamble to the Final Regulations confirms that if a pay period spans the last day of a taxable year, so that a payment of wages is partially attributable to services performed in the preceding taxable year, the payment is nevertheless considered remuneration on the date it is actually paid.

If an amount is not a regular wage, it is treated as paid when it is no longer subject to a substantial risk of forfeiture (or "vested"). For this purpose, an amount is vested if it is not subject to a substantial risk of forfeiture within the meaning of IRC section 457(f)(3)(B). In this case, the amount that is considered paid during the year is equal to the present value of the deferred compensation that became vested during the year.

The rules applicable to amounts that are not regular wages also apply to short-term deferrals, even though short-term deferrals are not considered deferred compensation for purposes of IRC sections 457(f) and 409A.

Observation: *Thus, for example, if an employer declares a bonus that vests on December 31, that bonus is treated as paid on December 31, even if it is paid early in the following year.*

Under the Final Regulations, if a future payment of deferred compensation is treated as paid on the date it becomes vested, the amount considered paid is equal to the present value of that future payment, determined on the date of vesting. However, the Final Regulations include an exception to this rule for amounts that are paid within 90 days of vesting. Under this exception, the employer can treat the entire amount paid on the future date as the present value on the date of vesting.

Observation: *For example, if an employer declares a \$10,000 bonus on December 31 that is scheduled to be paid the following February 15, the employer may treat \$10,000 as the amount considered paid on December 31, rather than the discounted value of \$10,000 (discounted from February 15 to December 31).*

In the case of deferred compensation, remuneration considered paid during a year includes earnings that accrue during the year on previously vested deferred compensation that had been treated as remuneration in a previous year. The determination of earnings for this purpose varies depending on whether the plan is an account balance plan or a nonaccount balance plan. For an account balance plan, earnings for a year are equal to the earnings that accrued on the “previously paid remuneration” during the year in question. “Previously paid remuneration” includes the original vested amount, plus previous years’ earnings that were considered paid in a prior year (and thus, subject to tax). For a nonaccount balance plan, earnings for a year are equal to the increase in present value during the year due solely to the passage of time.

Remuneration for which a deduction is disallowed under IRC section 162(m) is not considered remuneration for purposes of calculating the excise tax. However, these amounts are taken into account as remuneration in order to identify the top five highest-compensated employees to determine covered employees of an ATEO. The Final Regulations do not address the coordination of IRC sections 4960 and 162(m) in these circumstances, but instead reserve Treas. Reg. § 53.4960-5 as a place for future guidance.

Determination of Parachute Payments

A **parachute payment** is a payment in the nature of compensation made by an ATEO (or its predecessor or related organization) to a covered employee if, generally, the payment is contingent on employee’s involuntary separation from employment and the aggregated present value of the payment (and all similar payments) to the covered employee contingent on separation is greater than or equal to three times the covered employee’s base amount. A payment in the nature of compensation is any payment that arises out of an employment relationship, including holding oneself out as available to perform services or refraining from performing services. A payment is contingent on the separation of an employee if the employer would not make the payment in the absence of the employee’s involuntary separation of employment. Involuntary separation from employment is separation of

employment due to independent exercise of employer’s authority to terminate the employee’s services, other than due to employee’s request, if the employee is willing and able to continue performing services. Generally, the covered employee’s base amount is the average remuneration for the covered employee for the past 5 years. The preamble to the Final Regulations provides that the determination of the base amount, and parachute payments, and excess parachute payments, is similar to the excess parachute calculations under IRC section 280G.

Liability for Excise Tax

The IRC section 4960 excise tax is imposed at the tax rate under IRC section 11 (currently 21%). The excise tax is imposed on any excess remuneration or excess parachute payment to a covered employee by an ATEO or a related organization. Excess remuneration is the amount of remuneration paid by an ATEO or any related organization to any covered employee during an applicable year in excess of \$1 million. Any excess parachute payment is not included as excess remuneration. Any excess parachute payment made to a covered employee is subject to excise tax even if the covered employee’s total remuneration does not exceed \$1 million.

Each employer is liable for its portion of the excise tax that bears the same ratio of the total tax as the remuneration paid by the employer bears to the total remuneration paid to the covered employee by the employer and all related organizations. The excise tax is reported and paid on Form 4720, *Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code*.

Applicability Date

The Final Regulations apply to taxable years beginning after December 31, 2021 (the “Applicability Date”). A taxpayer may choose to apply the Final Regulations to a taxable year beginning after December 31, 2017 and before the Applicability Date, provided that the taxpayer applies the Final Regulations in their entirety and in a consistent manner. Until the Applicability Date of the Final Regulations, taxpayers may rely on the Notice, the Proposed Regulations or a reasonable, good faith interpretation of the statute. The preambles to the Notice and the Proposed Regulations provide certain positions that the IRS and Treasury have deemed not to be reasonable, good-faith interpretations of the statute.

Did you Know?

Electronic Filing of Form 2848 and 8821

On January 25, 2021, the IRS **announced** the roll-out of a new online process that allows certain tax professionals to remotely obtain signatures from individual and business clients, and to submit Forms 2848 and 8821 electronically. Authorized tax professionals can find the new "**Submit Forms 2848 and 8821 Online**" on the IRS.gov/tax-professionals page. At this time, the process to mail or fax Forms 2848 and 8821 to the IRS is still available. Signatures on mailed or faxed Forms 2848 and 8821 must be handwritten. Electronic signatures are not allowed on mailed or faxed Forms 2848 and 8821.

TE/GE Accomplishments Letter

The Internal Revenue Service released its **Fiscal Year 2020 Accomplishments Letter**. The Letter discusses the IRS accomplishments during the year including responses to the COVID pandemic such as switch to virtual examination and expansion of the use of digital signatures on the transmission of certain documents. As part of the compliance strategy, the IRS focused on hospital organizations with unrelated business income where the expenses significantly exceeded the gross income on the Form 990-T, Exempt Organization Business Income Tax Return. The IRS continued its compliance checks, which included some of the following inquiries: noncompliance with IRC section 501(r)(4) on Financial Assistance Policy for tax-exempt hospitals, and failure to file certain forms, including Form 990-T and Form 940, Employer's Annual Federal Unemployment Tax Return. In fiscal year 2020, TE/GE completed 1,078 reviews of hospital organizations and referred 66 hospitals for examination, 65 for possible noncompliance with the Affordable Care Act. The IRS has continued to expand its outreach with educational materials through electronic newsletters and issue snapshots on various topics within the exempt organization landscape.

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Multistate Tax

Disrupting the norm: Reinventing state tax compliance with technology

Mar 2 | 1 p.m. ET | 17 GMT

Changes in tax law, advancement of tax software and proliferation of data can make today's state tax compliance effort daunting. Through emerging technologies, companies can enhance the tax department value by re-focusing human efforts on higher value aspects of the process while technology addresses the more time-consuming ones. Participants will identify potential areas in their process for improvements and envision a technology roadmap for the future which can generate immediate value.

Register



Global Mobility, Talent & Rewards

Employment tax controversy: Proactive risk management

Mar 3 | 2 p.m. ET | 18 GMT

The United States Internal Revenue Service, like many tax authorities both inside and outside the US, continues to apply increased scrutiny on employment tax compliance. Notably, significant taxpayer-favorable adjustments on quarterly tax filings are being examined, a practice that occurred even before the 2020-2021 Employer Retention Credit (and its tax filing adjustments). Participants will gain insights on global employment tax developments and practical ways to anticipate and address related challenges.

Register



Tax Operations

Annual tax technology update: What's in store for 2021

Mar 25 | 1 p.m. ET | 17 GMT

In January 2020 many organizations had plans that included thoughtful road maps to guide their tax organizations. Fast forward through the pandemic, tax organizations must continue the path of digital transformation while driving value and fulfilling regulatory requirements. Participants will learn about recent and upcoming tech trends needed to not just support the new normal but to transform the tax lifecycle.

Register



Tax Accounting & Provisions

Financial accounting and reporting for income taxes: Important updates

Mar 31 | 1 p.m. ET | 17 GMT

What income tax accounting matters should you be thinking about in 2021? How will you continue to address ongoing impacts of the global pandemic, and how it has changed the way we work and operate? Participants can assess the latest developments and areas of complexity related to tax accounting and determine how those developments might affect their companies.

Register



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