Summary of Corporate Philanthropy Issues Related to IRC Sec. 4960
Tax on Excess Tax-Exempt Organization Executive Compensation

Key provisions: Section 4960 of the Internal Revenue Code imposes a tax equal to 21% on excess remuneration paid by an applicable tax-exempt organization (ATEO) to a covered employee in any taxable year. Excess remuneration is considered anything over $1,000,000. Remuneration can also include amounts paid by a related organization. Additionally, the tax will be imposed on any excess parachute payment by an organization to any covered employee. If liable for the tax, the ATEO employer, not the employee, is responsible for the tax.

In the corporate foundation/corporate giving context, the provisions of Section 4960 coupled with recent IRS guidance issued in the form of Notice 2019-09, have raised several important issues that require careful thought about the interpretation of the statute. These issues will need further clarification from the IRS. Specifically, in a situation where a for-profit corporation funds and operates a charitable foundation (most commonly a private foundation) in order to carry out all or a portion of its charitable giving, these unsettled issues include:

1. Is an employee of a for-profit corporation who serves on a voluntary basis as a member of the board of a foundation funded and operated by the corporation subject to the Sec. 4960 tax if he/she receives remuneration in excess of $1,000,000 from the corporation?
2. Is a corporate employee who serves in a voluntary position as an officer of the corporate foundation subject to the Sec. 4960 tax if he/she receives remuneration in excess of $1,000,000 from the corporation, but receives no compensation from the foundation?
3. When is an employee of the corporation a “covered employee” with respect to the corporate foundation for purposes of Sec. 4960?

In determining whether an ATEO or a related corporation is responsible for the Sec. 4960 tax with respect to any particular individual, it is helpful to analyze Sec. 4960 in steps.
Determination of Related Status:

The first step is to determine whether an ATEO and a for-profit corporation are “related” for purposes of the statute. Related organizations are defined in Sec. 4960(c)(4)(B) and for our analysis include (i) an entity that controls or is controlled by the ATEO; and (ii) an entity that is controlled by one or more persons which control the ATEO. “Control” is not defined in Sec. 4960, but Notice 2019-09 at Q-8 defines control in several ways including “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. In the corporate context, this means that if more than 50 percent of the directors of a corporate foundation are representatives of the corporation, the two entities are related.

Determination of Covered Employee Status:

Once it is determined that a corporate foundation and a corporation are related, the next step is to determine whether an individual is a covered employee. This is where we find the most uncertainty. Section 4960(b)(2) defines “covered employee” as “any employee (including any former employee) of the applicable tax-exempt organization if the employee (A) is one of the 5 highest compensated employees of the organization for the taxable year, or (B) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.” While Section 4960 does not provide additional details, Notice 2019-09 addresses “covered employees” by explaining how the 5 highest compensated employees are determined. According to the Notice, this determination is made “on the basis of his or her remuneration for services performed as an employee of a related organization with respect to the ATEO.” This statement has caused confusion as to the status of a corporate employee with respect to the ATEO and when corporate employees are providing services to the ATEO.

The Notice further addresses compensation paid by an ATEO to a member of its board of directors for serving in that capacity and states specifically that such compensation need not be included when determining remuneration (Q-12(d)). Additionally, the idea that a volunteer director of a corporate foundation would not be considered a covered employee of the ATEO, even if the director received compensation in excess of $1,000,000 from a related corporation, was confirmed by one of the authors of the Notice, and was based on the idea that a director of an ATEO who is not under the direction and control of the ATEO could not be considered an employee.

Another complication revealed by the Notice involves individuals who serve as “officers” of the corporate foundation. Page 13 of the Notice includes a statement that “only an ATEO’s common law employees (including officers) can be one of an ATEO’s five highest-compensation employees. Some commentators have interpreted this to mean that officers of a corporate foundation are always considered employees, even when serving without compensation, however this may not always be the case. Clarification is needed on this point, but there is no reason to assume that all officers of a corporate foundation must be considered covered employees.
Summary:

Variations in the facts can lead to different determinations regarding whether an individual is a covered employee for purposes of the Sec. 4960 tax, however our analysis suggests that when a corporate employee serves solely as a volunteer director of a related corporate foundation and receives no compensation from the foundation, that person may not be a covered employee for purpose of the tax. In a telephone conversation with one of the authors of the Notice, I was reminded that the Service will respect any reasonable, good-faith interpretation of the Statute and the guidance when a taxpayer takes a position on this issue. The Council will also be providing formal comments regarding Notice 2019-09 to the Service and is seeking input from its members and the field regarding the issues outlined here as well as other variations that may leave corporate foundations unclear regarding tax liability under Section 4960. Comments and input will be solicited on the Council’s website and can be directed to the author at Suzanne.Friday@cof.org.