

IRS NOTICE 2019-09: THE NEW EXCISE TAX ON EXCESS COMPENSATION AND PARACHUTE PAYMENTS

The 2017 federal tax law changes included a new section 4960. This section provides for a new 21 percent excise tax on the aggregate remuneration paid by certain tax-exempt organizations and “related organizations” to an employee if that employee is one of the top five compensated employees of the tax-exempt organization and is paid in excess of \$1 million. The tax also applies to “excess” parachute payments.

Arguably, there are situations when it is appropriate for such levels of compensation to be paid by a tax-exempt organization. However, the new law is now in effect and CMF members should remain mindful of it – and its potential impact to related organizations of the tax-exempt organization.

The “related organization” provision of Section 4960, the application of which is affirmed in Notice 3019-09, is designed to prevent a tax-exempt organization from shifting employee salaries to a related organization in an attempt to avoid the excise tax. Unfortunately, the provisions of Section 4960 and the guidance in the notice are fairly rigid and this could lead to innocent situations resulting in imposition of this tax.

For example, let’s assume that a private company is a “related organization” to a company private foundation and that the CFO of that private company serves as a volunteer officer of the company foundation. While the company foundation may pay none of the CFO’s salary, Section 4960 and the guidance provided in the notice would aggregate the salary paid by the private company and the foundation to the CFO. Assuming the CFO makes \$1.5 million a year, the private company may owe \$105,000 of excise taxes for its prorated share of the CFO’s aggregate compensation. In this example, the company foundation owes no tax as it did not pay any salary to the CFO.

This memo is not intended to provide a full explanation of Section 4960 or the notice. Rather, CMF is alerting its members of this new tax so that you are aware of its possible implications to both foundations and organizations related to those foundations. Members should consult with their tax counsel to determine the consequences and application of this tax to your foundation and any related organization.

CMF has submitted comments and proposed regulations to the U.S. Treasury Department and the Internal Revenue Service in response to the notice in an effort to clarify when the tax is applicable. It is our intent that those comments will help to limit any unintended consequences of the tax on our members.

