



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 53

[REG-122345-18]

RIN 1545-BO99

Tax on Excess Tax-Exempt Organization Executive Compensation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document sets forth proposed regulations under section 4960 of the Internal Revenue Code (Code), which imposes an excise tax on remuneration in excess of \$1,000,000 and any excess parachute payment paid by an applicable tax-exempt organization to any covered employee. The regulations affect certain tax-exempt organizations and certain entities that are treated as related to those organizations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Requests for a public hearing must be submitted as prescribed in the “**Comments and Requests for a Public Hearing**” section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at <https://www.regulations.gov> (indicate IRS and REG-122345-18) by following the online

instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and, to the extent practicable, on paper to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG-122345-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, William McNally at (202) 317-5600 or Patrick Sternal at (202) 317-5800; concerning submission of comments and/or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Section 4960 – Enactment and Essential Statutory Provisions

This document sets forth proposed regulations under section 4960 of the Internal Revenue Code (Code) amending part 53 of the Excise Tax Regulations (26 CFR part 53). Section 4960 was added to the Code by section 13602 of the Tax Cuts and Jobs Act, Pub. L. 115-97, 131 Stat. 2054, 2157 (TCJA). Section 4960(a) generally provides that an applicable tax-exempt organization (ATEO) that for a taxable year pays to a covered employee remuneration in excess of \$1 million or any excess parachute payment is subject to an excise tax on the amount of the excess remuneration plus

excess parachute payments paid during that taxable year at a rate equal to the rate of tax imposed on corporations under section 11 (21 percent for 2020).

ATEO is defined in section 4960(c)(1) as any organization which for the taxable year is exempt from taxation under section 501(a), is a farmers' cooperative organization described in section 521(b)(1), has income excluded from taxation under section 115(1), or is a political organization described in section 527(e)(1).

Covered employee is defined in section 4960(c)(2) as any employee (including any former employee) of an ATEO if the employee is one of the five highest-compensated employees of the organization for the taxable year or was a covered employee of the organization (or predecessor) for any preceding taxable year beginning after December 31, 2016.

Remuneration is defined in section 4960(c)(3)(A) as wages (as defined in section 3401(a)), except that such term does not include any section 402A(c) designated Roth contribution and includes amounts required to be included in gross income under section 457(f). The flush language of section 4960(a) provides that for purposes of applying section 4960(a)(1) and (2), remuneration is treated as paid when there is no substantial risk of forfeiture (within the meaning of section 457(f)(3)(B)) of the rights to such remuneration. Section 4960(c)(3)(B) provides that remuneration does not include any remuneration paid to a licensed medical professional (including a veterinarian) for the performance of medical or veterinary services.

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 such employee by any related person or governmental entity. Section 4960(c)(4)(B) provides that a

person or governmental entity is treated as related to an ATEO if such person or governmental entity: controls, or is controlled by, the ATEO; is controlled by one or more persons which control the ATEO; is a supported organization (as defined in section 509(f)(3)) during the taxable year with respect to the ATEO; is a supporting organization described in section 509(a)(3) during the taxable year with respect to the ATEO; or, in the case of an ATEO which is a voluntary employees' beneficiary association (VEBA) under section 501(c)(9), establishes, maintains, or makes contributions to the VEBA.

Excess parachute payment is defined in section 4960(c)(5)(A) as 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)(D) provides that rules similar to the rules of section 280G(b)(3) apply for purposes of determining the "base amount." Section 280G(b)(3) provides that the "base amount" is an individual's annualized compensation over the "base period," which is the individual's last five taxable years.

Parachute payment is defined in section 4960(c)(5)(B) as any payment in the nature of compensation to (or for the benefit of) a covered employee if the payment is contingent on the employee's separation from employment with the employer and 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 3-times the base amount. Section 4960(c)(5)(C) provides that a parachute payment does not include any payment: described in section 280G(b)(6) (relating to exemption from payments under qualified plans); made under or to an annuity contract described in section 403(b) or a plan described in section 457(b); made to a licensed medical

professional (including a veterinarian) to the extent the payment is for the performance of medical or veterinary services by the professional; or made to an individual who is not a highly compensated employee as defined in section 414(q).

The statute grants the Secretary authority to prescribe regulations as may be necessary to prevent avoidance of the tax under section 4960, including regulations to prevent avoidance of the tax through the performance of services other than as an employee or by providing compensation through a pass-through or other entity to avoid the tax.

Section 4960, added to the Code by section 13602(a) of TCJA, is effective for taxable years beginning after December 31, 2017.

II. Notice 2019-09

On December 31, 2018, the Treasury Department and the IRS issued Notice 2019-09 (2019-04 I.R.B. 403), setting forth initial guidance on the application of section 4960. The notice provides that taxpayers may rely on that guidance, and that, until further guidance is issued, in order to comply with the requirements of section 4960, taxpayers may base their positions upon a reasonable, good faith interpretation of the statute (including consideration of the legislative history, as appropriate). The notice also provides that certain interpretations of section 4960 are not consistent with a reasonable, good faith interpretation of the statutory language, and that the Treasury Department and the IRS intend to embody those positions as part of forthcoming proposed regulations. For further information about continued reliance on the guidance in Notice 2019-09, see part VII of the Explanation of Provisions section, titled “Proposed Applicability Dates.”

The notice provides that any future guidance will be prospective and requests comments on the topics addressed in the notice, as well as comments on any other issues arising under section 4960. The Treasury Department and the IRS considered each of the comments received in drafting these proposed regulations. These proposed regulations are based in large part on Notice 2019-09, with changes as appropriate based on comments received.

Explanation of Provisions

I. Scope of Proposed Regulations

These proposed regulations are intended to provide comprehensive guidance with regard to section 4960. These proposed regulations restate certain statutory definitions and define various terms appearing in section 4960. These proposed regulations also provide rules for determining: the amount of remuneration paid for a taxable year (including for purposes of identifying covered employees); whether a parachute payment is paid; whether excess remuneration is paid and in what amount; whether an excess parachute payment is paid and in what amount; and the allocation of liability for the excise tax among related organizations. These definitions and rules are proposed to apply solely for purposes of section 4960.

II. Definitions

A. Applicable tax-exempt organization

Commenters requested clarification of the status of governmental entities as ATEOs. As defined in section 4960(c)(1), “ATEO” includes an organization that has income excluded from taxation under section 115(1) or an organization that is exempt from taxation under section 501(a). 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” (as in sections 170(b)(1)(A)(v) and 170(c)(1)) 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 (1935-1 C.B. 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, under section 4960(c)(1), a governmental entity (including a state college or university) that does not have a determination letter recognizing its exemption from taxation under section 501(a) and that does not exclude income from

gross income under section 115(1) is not an ATEO. However, such a governmental entity 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.

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. 2020-5 (2020-1 I.R.B. 241, 246) (or the analogous section in any successor revenue procedure). However, an entity that excludes all or part of its income from gross income under section 115(1) is an ATEO regardless of whether it has a private letter ruling to that effect.

One commenter requested that proposed regulations specify that certain Federal instrumentalities are not subject to section 4960 excise tax because their enabling statute exempts them from all existing and future Federal taxes, reasoning that Congress did not specifically override the enabling statute in enacting section 4960. This reasoning, if accepted, would exempt many or most Federal instrumentalities from tax under section 4960, both as ATEOs and as related persons or governmental entities. Section 4960 explicitly designates as ATEOs all organizations exempt from taxation under section 501(a). Federal instrumentalities organized under an Act of Congress before July 18, 1984, and exempt from Federal income tax under such Act, are exempt organizations under section 501(a) because they are described in section 501(c)(1). A section 501(c)(1) organization is also a “person or governmental entity” that may be a related organization under section 4960(c)(4). Other Code provisions, such as section 511(a)(2)(A) (which extended unrelated business income tax to exempt organizations), specifically exclude section 501(c)(1) organizations (or particular section

501(c)(1) organizations).¹ In contrast, a similar exclusion was not included in section 4960 even though section 4960 applies to section 501(c)(1) organizations through reference to entities exempt under section 501(a). Thus, the Treasury Department and the IRS consider Federal instrumentalities to be subject to section 4960, and these proposed regulations do not adopt the commenter's suggestion. However, the Treasury Department and the IRS request comments regarding the application of section 4960 to these Federal instrumentalities.

These proposed regulations also address the status of foreign organizations as ATEOs. A foreign organization that otherwise qualifies as an ATEO will be treated as an ATEO unless it is described in section 4948(b) and the regulations thereunder. Section 4948(b) excludes foreign organizations from the application of excise taxes under chapter 42 (which includes section 4960) if they receive substantially all of their support (other than gross investment income) from sources outside the United States. Section 53.4948-1(a)(1) defines a "foreign organization" for this purpose as an organization not described in section 170(c)(2)(A) (that is, not created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States).

¹ Sections 3112 and 3308 provide that Federal instrumentalities are not exempt from Federal Insurance Contributions Act (FICA) taxes and Federal Unemployment Tax Act (FUTA) taxes, respectively, unless there is a specific provision of law granting that exemption. Prior to 1950, the predecessor to the FICA statute itself incorporated an exemption from FICA for "an instrumentality of the United States which is ... exempt from the employers' tax imposed by [the predecessor of section 3111 imposing the employer share of FICA tax] of the Internal Revenue Code by virtue of any other provision of law." Congress amended the statute in 1949 to exempt such instrumentalities only if they are exempt from the tax "by virtue of any provision of law which *specifically refers to such section* in granting such exemption." (Emphasis added.) Accordingly, prior to 1950, a general exemption was effective for purposes of FICA's predecessor but only because the general exemption was incorporated into the predecessor statute. That is not the case with section 4960. Rather federal instrumentalities are subject to section 4960 by virtue of being "organizations exempt from taxation under section 501(a)," and no exemption is provided.

One commenter asked whether a foreign organization can be a related organization. Section 4960(c)(4)(B) does not distinguish between domestic and foreign organizations for purposes of determining status as a related organization to an ATEO. However, the Treasury Department and the IRS are considering whether section 4948(b) should apply to exempt a foreign organization (that otherwise meets the definition of “related organization”) from liability for tax under section 4960(c)(4)(C). For example, in the context of the section 4958 excise tax on excess benefit transactions, an organization is excepted from status as an applicable tax-exempt organization if it is described in section 4948(b) (see §53.4958-2(b)(2)); thus, the tax under section 4958 does not apply to a disqualified person with respect to such a foreign organization. The Treasury Department and the IRS request comments on whether a foreign related organization described in section 4948(b) may be liable for tax under section 4960(c)(4)(C). The Treasury Department and the IRS also request comments on whether, for purposes of determining excess remuneration and allocating liability among the ATEO and related organizations, remuneration paid by a foreign related organization described in section 4948(b) should be taken into account even if the foreign related organization is exempt from liability for section 4960 tax.

B. Applicable year

1. In General

Section 4960(a)(1) refers to remuneration paid “for the taxable year,” but does not specify which taxpayer’s taxable year is referenced, 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. These proposed regulations provide that remuneration is paid for a taxable year if it is paid during the “applicable year,”

which is defined in these proposed regulations as the calendar year ending with or within an ATEO's taxable year.

Commenters were unsure whether "taxable year" refers to the taxable year of the ATEO, the related organization, or the covered employee. In addition, commenters noted that a tax-exempt organization's "taxable year" for purposes of section 4960 is not always obvious because generally a tax-exempt organization does not pay taxes and because section 4960 does not include its own definition of "taxable year." The Treasury Department and IRS developed the applicable year concept to resolve this ambiguity. Prescribing a single period resolves this issue and also reduces the administrative burdens that would arise if ATEOs and related organizations liable for the excise tax were required to allocate remuneration paid during a single calendar year to multiple non-calendar taxable years. Moreover, this approach reduces administrative burdens by aligning more closely with the calendar year reporting of compensation on Form W-2, "Wage and Tax Statement," and on Part VII and Schedule J of Form 990, "Return of Organization Exempt From Income Tax." Finally, the concept of an applicable year aligns with the period for identifying highly compensated employees under section 414(q), as required for determining whether certain payments are excess parachute payments.

Remuneration paid during an applicable year is also used for identifying the five highest-compensated employees for a taxable year and thus the covered employees of the ATEO for the taxable year (who will remain covered employees for all future taxable years). Generally, status as an ATEO will not change during the taxable year, in which case the full twelve months of the applicable year is used as the measuring period.

However, for the taxable year in which the ATEO becomes an ATEO (for example, if the ATEO is formed mid-year), or taxable year in which the ATEO ceases to be an ATEO (for example, due to corporate dissolution or revocation of exemption), adjustments to the standard applicable year may be necessary.

2. Rules Addressing the First Taxable Year an Organization Becomes an ATEO

For the taxable year in which an organization becomes an ATEO, the applicable year begins on the date the organization becomes an ATEO and ends on December 31 of that calendar year (“short applicable year”). For a calendar year taxpayer, the short applicable year is taken into account for the taxable year ending on the same date. For fiscal year taxpayers, the short applicable year is taken into account for the taxable year in which the short applicable year ends. If the ATEO has any related organizations, only the compensation paid (or treated as paid) by the related organizations during the short applicable year is taken into account for purposes of determining the amount of remuneration paid by the ATEO for that year.

3. Rules Addressing the Taxable Year in Which ATEO Status Terminates

For ATEOs with a calendar year taxable year, termination of ATEO status generally results in a short applicable year. The applicable year starts with January 1 and ends on the date of termination of ATEO status. For ATEOs with a fiscal year taxable year, termination of ATEO status may result in two applicable years being taken into account for the taxable year in which termination occurs. If the termination of ATEO status occurs on or before December 31 of the calendar year ending within the taxable year of the termination, then the applicable year for that taxable year starts January 1 and ends on the date of termination of status. If the termination of ATEO status occurs after December 31 of the calendar year ending within the taxable year of the

termination, then the ATEO has two applicable years for the taxable year: the full calendar year ending within the taxable year in which the termination of ATEO status occurs and the period starting on January 1 of the calendar year in which termination of ATEO status occurs and ending on the date of termination. While liability for the tax for both applicable years is aggregated and reported for the taxable year of termination of ATEO status, covered employees and the amount of the tax for each applicable year are determined separately for each applicable year. For example, if an ATEO with no related organizations paid a covered employee \$1.1 million of remuneration in the first applicable year (the full 12-month applicable year) and \$500,000 in the second applicable year (the short applicable year ending on the date of termination of ATEO status), the ATEO would be liable for excise tax only on the \$100,000 of excess remuneration it paid in the first (full) applicable year and would not be treated as paying any excess remuneration for the second (short) applicable year.

C. Employee

Section 4960(a) imposes a tax on excess remuneration and any excess parachute payment paid by an ATEO for the taxable year with respect to employment of a covered employee. Section 4960(c)(2) defines a “covered employee” as an employee (including any former employee) of the ATEO who meets certain other conditions. Accordingly, the tax imposed by section 4960(a) applies only with respect to a current or former employee of the ATEO.

Because the tax under section 4960(a)(1) applies to remuneration paid to a covered employee, and section 4960(c)(3)(A) defines “remuneration” as including wages under section 3401(a) (related to Federal income tax withholding) other than any

designated Roth contribution as defined in section 402A(c), these proposed regulations define “employee” consistent with the definition of “employee” for purposes of Federal income tax withholding in section 3401(c) and the regulations thereunder. Specifically, the proposed regulations cross-reference the definition of “employee” in §31.3401(c)-1, which includes common-law employees, officers or elected or appointed officials of governments, or agencies or instrumentalities thereof, and certain officers of corporations. These proposed regulations reiterate certain rules from §31.3401(c)-1 that are particularly relevant to section 4960, including the rules that a member of a board of directors of a corporation is not an employee of the corporation (in the capacity as a director), and that an officer is an employee of the entity for which the officer serves as an officer (unless the officer performs no services or only minor services and neither receives, nor is entitled to receive, any remuneration, as discussed in part II.E. of this preamble, titled “Covered employee”). Accordingly, the Treasury Department and the IRS did not adopt one commenter’s suggestion that an officer of an ATEO not be presumptively treated as an employee of the ATEO. For further discussion of this definition of “employee” and other proposed rules intended to address employees of non-ATEO related organizations performing limited or temporary services for the related ATEO (in particular, while also receiving compensation from the non-ATEO related organization), see part II.E.2. of this preamble, titled “Volunteer Services and Similar Exceptions.”

D. Employer

Section 4960(b) provides that the employer is liable for the tax imposed under section 4960(a). Similar to the definition of “employee,” these proposed regulations

define “employer” consistent with the definition of “employer” for purposes of Federal income tax withholding in section 3401(d) and the regulations thereunder, without regard to the special rules in section 3401(d)(1) and (2). Accordingly, control of the payment of wages is not relevant for determining whether an entity is the employer for section 4960 purposes. Further, these proposed regulations provide that a person or governmental entity does not avoid status as an employer of an employee by using a third-party payor to pay remuneration to that employee. Third-party payors include a payroll agent, common paymaster, statutory employer under section 3401(d)(1), or certified professional employer organization under section 7705 (under the Code, an “employer” for subtitle C purposes only). Further, consistent with existing principles for determining the employer, under certain facts and circumstances, a management company may also be acting as a third-party payor for the employees of its ATEO client, rather than as the common law employer of the employees. Thus, as set forth in these proposed regulations, remuneration that is paid by a separate organization to an individual for services the individual performed as an employee of the ATEO, whether related to the ATEO or not, is deemed remuneration paid by the ATEO for purposes of section 4960. These proposed regulations also specify 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.

In addition, these proposed regulations provide that the sole owner of an entity that is disregarded as separate from its owner under §301.7701-2(c)(2)(i) is treated as the employer of any employee of the disregarded entity, notwithstanding that the entity is regarded for subtitle C purposes under §301.7701-2(c)(2)(iv).

E. Covered employee

1. In General

Consistent with section 4960(c)(2), these proposed regulations define “covered employee” to mean any individual who is one of the five highest-compensated employees of the ATEO for a taxable year or was a covered employee of the ATEO (or any predecessor) for any preceding taxable year beginning after December 31, 2016. These proposed regulations provide that whether an employee is one of the five highest-compensated employees of an ATEO is determined separately for each ATEO and not for the entire group of related organizations. As a result, a group of related ATEOs can have more than five highest-compensated employees for a taxable year. Similarly, an employee may be a covered employee of more than one ATEO in a related group of organizations for a taxable year. Once an employee is a covered employee of an ATEO, the employee continues to be a covered employee for all subsequent taxable years of that ATEO. One commenter suggested a minimum dollar threshold for determining the five highest-compensated employees. These proposed regulations do not set a minimum dollar threshold for an employee to be a covered employee because there is no minimum threshold provided in the statute. Thus, an employee need not be paid excess remuneration or an excess parachute payment or be a highly compensated employee within the meaning of section 414(q) to be a covered employee of an ATEO for a taxable year and all future taxable years. (Note, however, that if an ATEO never pays a covered employee excess remuneration or an excess parachute payment, then there would be no section 4960 excise tax with respect to the covered employee.)

Commenters suggested 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 has elapsed during which the employee was not an active employee of the ATEO. These proposed regulations do not adopt that suggestion because such a rule would be inconsistent with the statute.

The Treasury Department and the IRS considered using certain existing reporting standards for determining the amount of compensation paid to an employee for purposes of identifying the five highest-compensated employees for a taxable year under section 4960, 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. These proposed regulations generally use remuneration paid during the applicable year for purposes of identifying an ATEO's five highest-compensated employees for a taxable year because remuneration is an appropriate representation of compensation earned by an employee and it is more administrable to use a single standard for identifying covered employees and computing the tax, if any, imposed by section 4960(a)(1). However, these proposed regulations provide that while remuneration for which a deduction is disallowed under section 162(m) is generally not taken into account for purposes of determining the amount of remuneration paid for a taxable year, it is taken into account as remuneration paid for purposes of determining an ATEO's five highest-compensated employees. This rule is needed to ensure proper coordination between the rules under section 162(m) and the rules under section 4960.

These proposed regulations also provide that, for purposes of determining whether an employee is one of an ATEO's five highest-compensated employees for a taxable year, remuneration paid by the ATEO during the applicable year is aggregated with remuneration paid by any related organization during the ATEO's applicable year,

including remuneration paid by a related for-profit organization or governmental entity, for services performed as an employee of such related organization. For a description of proposed rules intended to address certain situations in which an employee of a non-ATEO performs limited or temporary services for a related ATEO, see part II.E.2. of this preamble, titled “Volunteer Services and Similar Exceptions.”

Consistent with section 4960(c)(3)(B), these proposed regulations provide that for purposes of identifying an ATEO’s five highest-compensated employees for a taxable year, remuneration paid during the applicable year for medical services is not taken into account. See H. Rept. 115-466, at 494 (2017) (“[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.”). For a discussion of the proposed rules addressing identification of remuneration paid for medical or veterinary services, see section II.F. of this preamble, titled “Medical Services.”

2. Volunteer Services and Similar Exceptions

Many commenters expressed concern that the rules for identifying an ATEO’s five highest-compensated employees provided in Notice 2019-09 would subject a non-ATEO to the excise tax on remuneration it pays to an employee who performs limited or temporary services for a related ATEO and who typically receives remuneration only from the non-ATEO. In this scenario, the allocation rules in Notice 2019-09 would allocate the entire excise tax to the non-ATEO. In addition, because the individual would continue to be treated as a covered employee of the ATEO for all subsequent taxable years, the non-ATEO would continue to be subject to the excise tax on any excess

remuneration it paid to that employee for his or her remaining period of service as an employee of the non-ATEO, even if the individual ceased performing services as an employee of the ATEO (for example, upon “returning” to the non-ATEO after a temporary assignment at the ATEO). The commenters criticized this result, suggesting that the individual typically is performing services for the ATEO solely as a “volunteer” and that application of the excise tax would force significant changes to existing structures to avoid the tax, including possible dissolution of the ATEO or utilization of ATEO funds to procure separate services from other individuals with no employment relationship at the related non-ATEO. They argued that Congress did not intend to impose the excise tax under section 4960 in these circumstances.

Commenters suggested several modifications to the guidance provided in Notice 2019-09 in order to avoid these results. After consideration of the comments received, the Treasury Department and the IRS propose exceptions to the definition of “employee” and “covered employee” and the rules for identifying the five highest-compensated employees to address these concerns. These exceptions are intended to ensure that certain employees of a related non-ATEO providing services as an employee of an ATEO are not treated as one of the five highest-compensated employees of the ATEO, provided that certain conditions related to the individuals’ remuneration or hours of service are met. To avoid manipulation of the rules through the deferral of compensation, in determining whether an employee is one of the five highest-compensated employees, a grant of a legally binding right to vested remuneration is considered to be remuneration paid, and any grant of a legally binding right to nonvested remuneration by the ATEO (or a related ATEO), for example, under a

deferred compensation plan or arrangement, disqualifies the ATEO from claiming a relevant exception.

Remuneration paid to an individual who is never an employee of the ATEO is not taken into account for purposes of section 4960. For example, an individual who, under all the facts and circumstances, performs services for the ATEO solely as a bona fide independent contractor is not an employee of the ATEO and thus is not considered for purposes of determining the ATEO's five highest-compensated employees. Similarly, an individual who, under all the facts and circumstances, performs services solely as a bona fide employee of a related organization, including a related organization that provides services to the ATEO, is not an employee of the ATEO and thus is not considered for purposes of determining the ATEO's five highest-compensated employees.

In addition, these proposed regulations provide that for purposes of determining an ATEO's five highest-compensated employees for a taxable year, an employee is disregarded if neither the ATEO nor any related organization pays remuneration or grants a legally binding right to nonvested remuneration for services the individual performed as an employee of the ATEO or any related organization. This clarifies that if none of the ATEO's employees received remuneration from the ATEO or from a related organization, then the ATEO has no covered employees (instead of requiring that some employee be treated as a covered employee). Note, however, that employees who had been properly classified as covered employees in any prior taxable year would continue to be covered employees.

This rule also addresses concerns commenters expressed regarding situations in which the ATEO (and its related organizations) may not provide an employee a salary or monetary compensation but may provide other nontaxable benefits. The Treasury Department and the IRS note that benefits excluded from gross income are not considered remuneration, including expense allowances and reimbursements under an accountable plan (see §1.62-2) and most insurance for liability arising from service with an ATEO, such as directors and officers liability insurance (see §1.132-5(r)(3)). The Treasury Department and the IRS request comments on whether certain taxable benefits, such as employer-provided parking in excess of the value excluded under section 132, should be disregarded for purposes of determining whether an individual receives remuneration for services for this purpose and, if so, what standards should apply to identify those benefits.

Several commenters suggested that an employee who works for an ATEO for a small percentage of the employee's total hours worked for the ATEO and all its related organizations should be disregarded for purposes of determining that ATEO's five highest-compensated employees. To accommodate those situations in which an employee of a related non-ATEO provides limited services as an employee of the ATEO without any payment of compensation by the ATEO, these proposed regulations also provide a "limited-hours" exception for purposes of determining the five highest-compensated employees of the ATEO. Under this exception, an employee of an ATEO is disregarded for purposes of determining the ATEO's five highest-compensated employees for a taxable year if neither the ATEO nor any related ATEO pays remuneration or grants a legally binding right to nonvested remuneration to the

employee for services performed for the ATEO and the employee performs only limited services for the ATEO. For purposes of the requirement that an employee not be paid remuneration by the ATEO, the ATEO is not deemed to pay remuneration for services performed for the ATEO that is paid by a related organization that also employs the individual, so long as the ATEO does not reimburse the payor and is not treated as paying remuneration paid by a related organization for services performed for the related organization (although, as discussed in section III.A of this preamble, titled “In General,” for other purposes, this remuneration generally is treated as paid by the ATEO).

In addition, an employee qualifies for this exception only if the hours of service the employee performs as an employee of the ATEO comprise 10 percent or less of the employee’s total hours of service for the ATEO and all related organizations during the applicable year. For example, an employee of an ATEO and a related organization who works on average 10 hours per month as an employee of the ATEO (or 120 hours for the applicable year) and works on average 165 hours per month as an employee of the related organization (or 1,980 hours for the applicable year) is not counted among the ATEO’s five highest-compensated employees for the taxable year, regardless of the amount of the employee’s total remuneration, provided the ATEO does not pay the employee any remuneration. In addition, these proposed regulations provide a safe harbor under which an employee who performs fewer than 100 hours of services as an employee of an ATEO (and all related ATEOs) during an applicable year is treated as having worked less than 10 percent of the employee’s total hours for the ATEO (and all related ATEOs).

Commenters have raised concerns that an employee of a taxable organization who performs more significant services for a related ATEO as an employee of the ATEO, but with no remuneration paid by the ATEO, may be treated as one of the ATEO's five highest-compensated employees solely based on the remuneration the employee receives from his or her regular, permanent employment with the related taxable organization. The Treasury Department and the IRS understand that the common practice of a taxable organization donating services of their employees to a related ATEO, without the ATEO incurring any expense for these services, is often premised on a desire to assist the ATEO in furthering its exempt purposes without the ATEO inadvertently paying compensation that may be subject to excise tax under sections 4941, 4945, or 4958. Furthermore, in these situations, the ATEO is not expending any of its funds for the employee's services. Regarding the reason for enacting section 4960, the House Report referenced payment of excessive compensation using tax-exempt funds, as well as aligning the tax treatment between for-profit and tax-exempt employers. Specifically, the House Report provided:

The Committee believes that tax-exempt organizations enjoy a tax subsidy from the Federal government because contributions to such organizations generally are deductible and such organizations generally are not subject to tax (except on unrelated business income). As a result, such organizations are subject to the requirement that they use their resources for specific purposes, and the Committee believes that excessive compensation (including excessive severance packages) paid to senior executives of such organizations diverts resources from those particular purposes. The Committee further believes that alignment of the tax treatment of excessive executive compensation (as top executives may inappropriately divert organizational resources into excessive compensation) between for-profit and tax-exempt employers furthers the Committee's larger tax reform effort of making the system fairer for all businesses.

H. Rep. 115-409, 115th Cong., 1st Sess. 333 (Nov. 13, 2017). Accordingly, these proposed regulations also provide a "nonexempt funds" exception for employees of

controlling taxable organizations that perform more substantial services as an employee of the ATEO under certain circumstances.

Under the nonexempt funds exception, an employee is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if neither the ATEO, nor any related ATEO, nor any taxable related organization controlled by the ATEO pays the employee of the ATEO any remuneration for services performed for the ATEO or grants a legally binding right to nonvested remuneration to the employee. As under the limited hours exception, for purposes of the requirement that an employee not be paid remuneration by the ATEO, the ATEO is not deemed to pay remuneration that is paid by a related organization that also employs the individual, so long as the ATEO does not reimburse the payor and is not treated as paying remuneration paid by a related organization for services performed for the related organization. In addition, to prevent indirect payment of remuneration by the ATEO, related ATEOs, or taxable related organizations controlled by the ATEO, the related taxable organization paying the employee remuneration must not provide services for a fee to the ATEO, related ATEOs, or their controlled taxable related organizations.

Further, the employee must have provided services primarily to the related taxable organization or other non-ATEO (other than a taxable subsidiary of the ATEO) during the applicable year. For purposes of this exception, an employee is treated as having provided services primarily to the related taxable organization or other non-ATEO (other than a taxable subsidiary of the ATEO) only if the employee provided services to the related non-ATEO for more than 50 percent of the employee's total hours worked for the ATEO and all related organizations (including ATEOs) during the

applicable year. For example, an individual who works 40 total hours per week, 15 of which are for an ATEO and 25 of which are for a related taxable organization, would primarily provide services for the related taxable organization. The determination is made for each applicable year, so an employee who provides services full-time for 3 ½ months of an applicable year to an ATEO and the remaining 8 ½ months to the related taxable organization would be considered as providing services primarily to the related taxable organization.

The “limited services” exception set forth in Q/A–10(b) of Notice 2019-09 provides that an employee is not one of an ATEO’s five highest-compensated employees for a taxable year if, during the applicable year, the ATEO paid less than 10 percent of the employee’s total remuneration during the applicable year 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 applicable year, then this exception does not apply to the ATEO that paid the employee the most remuneration during that applicable year. These proposed regulations adopt a substantially similar rule that has been modified to simplify the structure of the exception and to clarify that the exception does not apply if the ATEO has no related ATEOs.

Several other comments were received relating to the issue of employees of a non-ATEO providing temporary or limited services to a related ATEO. Several commenters suggested that “volunteers” should be excluded from the definition of “employee.” The term “employee” for Federal tax purposes generally is understood to

refer to a common-law employee. Whether a service provider is a common-law employee generally turns on whether the service recipient has the right to direct and control the service provider, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. See, e.g., §31.3121(d)-1(c)(2). The determination does not depend on whether or how the individual is compensated or by which person. The Treasury Department and the IRS do not adopt the suggestion to modify the common-law standard for determining employee status solely for purposes of section 4960 or to use a definition other than the common law standard. Nonetheless, the limited hours and nonexempt funds exceptions provided in these proposed regulations exclude certain employees that some may view as “volunteers” from status as one of an ATEO’s five highest-compensated employees, and, as discussed in section II.C. of this preamble, titled “Employee,” these proposed regulations exclude certain “volunteer” officers, consistent with employment tax regulations.

A commenter suggested that the definition of “employee” under Notice 2019-09 be modified so that officer status is not presumptive of common-law employee status. Another commenter suggested that officers who are not paid directly by the ATEO and who perform only minor services for the ATEO be excluded either from the definition of “employee” or from the five highest-compensated employees. Under section 4960(c)(3)(A), whether an amount is remuneration generally is based on whether an amount is wages as defined in section 3401(a). Section 31.3401(c)-1(f) provides that an officer generally is treated as an employee, but provides an exception under which an employee of the corporation does not include an officer who performs no services, or

performs only minor services, and who neither receives, nor is entitled to receive, any remuneration. Because the definition of “remuneration” is tied to the definition of “wages” under section 3401(a) and §31.3401(c)-1(f) provides that officers generally are treated as employees, the Treasury Department and the IRS do not agree that it is appropriate to provide categorically that officers are not employees. However, consistent with §31.3401(c)-1(f), these proposed regulations define “employee” to exclude any officer who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration.

A commenter suggested that an exception to the definition of “employee” for purposes of section 4960 that would align with the “volunteer” exception used for purposes of reporting employee compensation on the Form 990. Under this exception, an employee of a for-profit entity would not be considered an employee of the ATEO if the ATEO does not control the for-profit entity, the for-profit entity does not provide management services for a fee to the ATEO, and the employee provides only “volunteer” services to the ATEO (that is, services for which the ATEO pays no compensation to the employee). The Treasury Department and the IRS decline to adopt this approach because the considerations underlying the Form 990 definition of “employee” are different than those underlying section 4960. However, the limited hours and nonexempt funds exceptions provided in these proposed regulations are similar to the Form 990 “volunteer” exception and will cover many of the same employees.

Commenters suggested that an individual not be treated as one of an ATEO’s five highest-compensated employees if the compensation paid directly by the ATEO (regardless of the compensation paid by one or more related organizations) did not

meet a certain threshold amount or if the employee did not receive from the ATEO more than a threshold percentage of total compensation from the ATEO and its related organizations. Commenters also suggested that, for purposes of determining an ATEO's five highest-compensated employees, the amount paid to an employee should include only the amount paid by an ATEO (or by an ATEO and related ATEOs) and not by any of its related organizations (or not by any of its related non-ATEOs). The Treasury Department and the IRS do not adopt these suggestions because of concerns that these standards would permit taxpayers to restructure compensation arrangements so that a related organization pays compensation on behalf of an ATEO or break up operations into multiple ATEOs, each paying below the threshold, in order to control the identification of the ATEO's covered employees (and, in particular, would permit taxpayers to ensure that any individuals being paid overall remuneration in excess of \$1 million are not identified as covered employees).

Commenters also suggested that, for purposes of determining an ATEO's five highest-compensated employees, the amount paid to an employee should be measured only by reference to compensation paid to the employee for services rendered as an employee of the ATEO (regardless of the payor). The Treasury Department and the IRS do not adopt this suggestion because an arrangement between entities for compensating employees of two or more of the entities may not accurately reflect the relative value of the services an employee provides to each of the entities. In addition, due to the highly factual nature of the analysis and the potential for differing conclusions, such a rule would not result in a predictable standard for taxpayers or the

IRS to apply. However, the limited hours and nonexempt funds exceptions set forth in these proposed regulations are intended to address the concerns of these commenters.

Finally, a commenter suggested that a rule be provided under which an ATEO is permitted to choose one of several permissible methods to determine its five highest-compensated employees. A standard that would permit an ATEO to select among various identification methods would create administrative burdens and complexities not only in implementing that ATEO's election, but also in coordinating among related ATEOs (and their related non-ATEOs) with differing identification methods, applying changes in methods selected by ATEOs, and determining the consequences of corporate transactions involving ATEOs (for example, a merger of two ATEOs using two different identification methods). In addition, the Treasury Department and the IRS anticipate that the definitions of "employee" and "five highest-compensated employees" in these proposed regulations will address the issues raised by commenters concerning employees of non-ATEOs performing limited or temporary services for a related ATEO. For these reasons, these proposed regulations do not adopt this suggestion. However, the Treasury Department and the IRS continue to invite comments on any modifications to these proposed regulations with respect to identifying an ATEO's five highest-compensated employees that are consistent with the statutory provisions, treat similarly situated taxpayers consistently, do not permit improper avoidance of the provisions, and are administrable and not overly burdensome.

F. Medical services

Section 4960(c)(3)(B) provides that remuneration for purposes of section 4960 does not include the portion of any remuneration paid to a licensed medical professional

(including a veterinarian) that is for the performance of medical or veterinary services by such professional. Section 4960(c)(5)(C)(iii) provides a substantially similar exception from the definition of “parachute payment.” Commenters requested clarification of the types of services that for this purpose are medical or veterinary services.

These proposed regulations define “medical services” as the diagnosis, cure, mitigation, treatment, or prevention of disease in humans or animals; services provided for the purpose of affecting any structure or function of the human or animal body; and other services integral to providing such medical services, that are directly performed by a licensed medical professional. This standard is consistent with the statement in the Conference Report to TCJA, H. Rept. 115-466, at 494 (2017) that the exception applies only to remuneration “directly related” to the performance of medical services (including veterinary services). This standard is based on the definition of “medical care” under section 213(d)(1)(A) and §1.213-1(a), which is a developed area of Federal tax law. Under these proposed regulations, only the remuneration paid by the employer to a licensed medical professional for the actual provision of medical services (or administrative tasks integral to such services) is disregarded for purposes of determining the amount of remuneration paid to the licensed medical professional for the applicable year (and the amount of any parachute payment under section 4960(c)(5)(C)(iii)). The proposed regulations provide that certain administrative tasks, such as creating patient records, are so integral to performing medical services that they constitute the performance of medical services. Further, the proposed regulations provide that, for purposes of section 4960, remuneration paid to a licensed medical professional for teaching or research services does not qualify for the exclusion from

remuneration under section 4960(b)(3)(B) (or the exclusion from amounts treated as a parachute payment under section 4960(c)(5)(C)(iii)) except to the extent those services constitute medical services.

The Conference Report to TCJA states that “[a] medical professional for this purpose includes a doctor, nurse, or veterinarian.” H. Rept. 115-466, at 494 (2017). To further clarify the standard, these proposed regulations provide that a “licensed medical professional” is an individual who is licensed under state or local law to perform medical services. In addition to doctors, nurses, and veterinarians, as listed in the legislative history, a licensed medical professional generally would include dentists and nurse practitioners and may include other medical professionals, depending on the applicable state or local law.

For a discussion of other issues related to remuneration for medical or veterinary services, including a proposed rule for allocating remuneration received for a combination of medical and non-medical services, see part III of this preamble, titled “Remuneration.”

G. Predecessor organization

Section 4960(c)(2)(B) provides that a covered employee includes any employee who was a covered employee of the ATEO (or any predecessor) for any preceding taxable year beginning after December 31, 2016. Because, under section 4960(c)(2), a covered employee must be (or have been) an employee of an ATEO, the predecessor must also have been an ATEO. Thus, an individual who is a covered employee of an ATEO (or of an ATEO predecessor of an ATEO) for one taxable year remains a covered employee of that ATEO (and any successor ATEOs) for subsequent taxable years.

These proposed regulations define “predecessor” by reference to several enumerated categories of organizational changes, including acquisitions, mergers, other reorganizations, and changes in tax-exempt status. A predecessor ATEO ordinarily is an ATEO that has transferred, by any of several legal means, its assets and operations to another pre-existing or newly created ATEO (the successor of the predecessor ATEO). This definition generally is consistent with the proposed regulations under section 162(m), 84 FR 70356 (December 20, 2019), with certain differences discussed in this section of the preamble. Section 162(m)(1) disallows a deduction for compensation in excess of \$1 million paid by publicly-held corporations to certain executive officers, and the proposed regulations under section 162(m) define certain similar terms, including predecessor organization.

These proposed regulations provide that if an acquiror ATEO acquires at least 80 percent of the operating assets or total assets (determined by fair market value on the date of acquisition) of a target ATEO, then the target ATEO is a predecessor of the acquiror ATEO (the 80 percent asset transfer rule). However, the proposed regulations provide that only the target ATEO’s covered employees that commence the performance of services for the acquiror ATEO (or an organization related to the acquiror) during the period beginning 12 months before and ending 12 months after the date on which all events necessary for the acquisition have occurred become the acquiror ATEO’s covered employees (the 24-month services rule). For acquisitions of assets that occur over time, these proposed regulations generally provide that only acquisitions that occur within a twelve-month period are taken into account for purposes of applying the 80 percent asset transfer rule, though the period is extended during any

period in which there is a plan to acquire the target's assets. The acquisition may be by gift or for bona fide consideration.

The 24-month services rule differs from the corresponding rule in the proposed regulations under section 162(m) in that for section 162(m), the proposed rule relates to hiring by the publicly held corporation (including its affiliated group), whereas the rule in these proposed regulations relates to hiring by an ATEO or any related organization. This difference reflects a structural difference in the two statutes, but the two rules are meant to have substantively similar effects.

These proposed regulations provide that a predecessor of an acquiror ATEO includes an ATEO that is acquired (target), or the assets of which are acquired, by another ATEO (acquiror) in most corporate reorganization transactions defined in section 368. Accordingly, the covered employees of a target are also covered employees of the acquiror. For nonprofit corporations, such reorganizations would commonly include mergers described in section 368(a)(1)(A). These proposed regulations also treat as a predecessor an organization that merely changes its form or place of organization as described in section 368(a)(1)(F).

The categories of organizational changes in these proposed regulations resulting in a predecessor and a successor are not mutually exclusive. For example, these proposed regulations treat a restructuring ATEO that changes its organizational form or place of organization as a predecessor of the surviving organization. Many or most such transactions, though not all, result in the same treatment under one or more of the 80

percent asset transfer rule, section 368(a)(1)(F), or Rev. Proc. 2018-15, 2018-9 I.R.B. 378.²

ATEOs generally are defined as organizations exempt from tax under one of several Code sections. For purposes of section 4960(c)(2)(B), an ATEO may be a predecessor of itself due to its moving in and out of status as an ATEO. Specifically, these proposed regulations provide that a predecessor of an ATEO includes an ATEO that, after ceasing to be an ATEO, again becomes an ATEO effective for a taxable year (or part of the taxable year) ending before the date that is 36 months following the due date (disregarding any extensions) for the filing of the ATEO's information return under section 6033, such as Form 990 (or Federal income tax return in the case of section 115 instrumentalities or section 521 farmers' cooperatives), for the most recent taxable year during which the organization was an ATEO. The 36-month limitation is included for reasons similar to those underlying the proposed definition of "predecessor" for purposes of section 162(m)(3)(C). See Prop. §1.162-33(c)(2)(ii)(C) and (H). These proposed regulations also provide that a predecessor of an ATEO includes any predecessor of its predecessor (thus, there may be a chain of predecessors).

ATEOs, which are defined in section 4960(c)(1), differ in their organizational structures and basis for tax exemption and in the types of reorganizational changes that they may undergo. For instance, predecessor rules involving transfers of stock generally will apply only to a limited class of ATEOs because ATEOs generally are not stock

² Because these proposed regulations essentially treat the covered employees of a predecessor of an ATEO as the covered employees of the ATEO, these proposed regulations do not distinguish between a reorganization of an ATEO in which the restructured organization must re-apply for recognition of exemption and a reorganization in which the restructured organization is still recognized as exempt, such as pursuant to certain changes in form or place of organization.

corporations. These proposed regulations specify that, in the case of an election to treat as an asset purchase either the sale, exchange, or distribution of stock pursuant to regulations under section 336(e) or the purchase of stock pursuant to regulations under section 338, the ATEO is treated as the same organization before and after the transaction for which the election is made. Comments are requested on the application of these rules to ATEOs and whether any other types of transactions involving ATEOs should be analyzed to determine if the predecessor rules do or should apply.

H. Related organization

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.³ Similar to the comment that only remuneration paid by the ATEO or related ATEO should be considered for purposes of determining an ATEO's five highest-compensated employees (described in paragraph II.E.1. of this preamble, titled "In General"), one commenter requested that, for purposes of applying the definition of "remuneration," the phrase "any related person or governmental entity" be limited to the employer ATEO and any related ATEOs, but not any related non-ATEOs. Because section 4960(c)(4)(B) does not include this limitation in the definition of a "related organization," these proposed regulations do not adopt this suggestion. Rather, these proposed regulations include in the definition of "remuneration" any remuneration paid by the employer ATEO, related ATEOs, and

³ The proposed regulations refer to related persons and governmental entities collectively as related organizations.

related non-ATEOs (including for-profit entities, nonprofit entities that are not ATEOs, and governmental entities that are not ATEOs).

Section 4960(c)(4) does not provide a definition of “control” for purposes of identifying related organizations. For purposes of defining “control” within the meaning of section 4960(c)(4)(B)(i) and (ii), two commenters suggested using the control standard under §1.414(c)-5, with one of the commenters suggesting replacement of the “at least 80 percent” standard with a “more than 50 percent” standard to align with the Form 990 instructions. Such a standard is similar to the definition of “control” under section 512(b)(13)(D).

Consistent with Notice 2019-09, Q/A–8, for this purpose, these proposed regulations generally utilize the definition of “control” set forth in section 512(b)(13)(D) and §1.512(b)-1(l)(4). That standard (and its “greater than 50 percent” threshold) generally aligns the definition of “related organization” for purposes of section 4960 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 and remuneration from related organizations, and determining liability (if any) under section 4960. Use of a “greater than 50 percent” standard also aligns more closely with other exempt organization control tests and prevents abuse that may occur in the section 4960 context if a higher percentage threshold for control were adopted.

Following the standard in section 512(b)(13)(D), these proposed regulations define control of a stock corporation as ownership (by vote or value) of more than 50 percent of its stock, control of a partnership as ownership of more than 50 percent of its

profits or capital interests, and control of a trust with beneficial interests as ownership of more than 50 percent of its beneficial interests. Consistent with the rule set forth in section 512(b)(13)(D)(ii), these proposed regulations provide that the attribution rules of section 318 apply in determining constructive or indirect ownership of stock in a stock corporation and that similar principles apply in determining constructive or indirect ownership of partnership interests or beneficial interests in a trust. For example, under section 318(a)(1), an individual is considered to own stock owned by the individual's spouse, child, grandchild, or parent. In general, the principles of section 318 are not readily applicable to nonstock organizations, which do not have ownership interests like other entities. However, some of the principles may be applied by analogy (such as proportional ownership under section 318(a)(2)), as set forth in these proposed regulations and examples. Similar rules apply in determining an indirect excess benefit transaction through a controlled entity in §53.4958-4(a)(2)(ii)(B) for purposes of imposing the excise tax in section 4958 on excess benefit transactions. The Treasury Department and the IRS request comments on other circumstances for which clarifying regulations or examples would be helpful or whether a different standard should be considered.

Since most tax-exempt organizations are nonstock organizations, these proposed regulations also set forth a rule of "control" in the context of nonstock organizations to determine if the nonstock organization is a related organization. For this purpose, the proposed regulations define a "nonstock organization" as a nonprofit organization or other organization without owners, including a governmental entity. Similar to several other provisions and regulations dealing with controlled tax-exempt

organizations (§1.512(b)-1(l)(4)(i)(b), §53.4958-4(a)(2)(ii)(B)(1)(iii), and §1.414(c)-5(b)),⁴ these proposed regulations provide that a person controls a nonstock organization under either a “removal power” test or a “representative” test.

Under the removal power test, a person controls a nonstock organization if the person has the power, directly or indirectly, to remove more than 50 percent of the trustees or directors of the nonstock organization and designate new trustees or directors. These proposed regulations specify that power to remove at regular intervals (for example, at the end of a board member’s term of years) is sufficient for removal power to exist.

Under the representative test, a person or governmental entity generally controls a nonstock organization if more than 50 percent of the nonstock organization’s directors or trustees are also trustees, directors, officers, agents, or employees of the person or governmental entity. Unlike the representative test in §1.512(b)-1(l)(4)(i)(b), §53.4958-4(a)(2)(ii)(B)(1)(iii), and §1.414(c)-5(b), these proposed regulations expressly include an officer of the person or governmental entity as a representative for purposes of determining control of the nonstock organization.

One commenter suggested the representative test is overbroad, resulting in deemed control by the person because of the person’s mere capacity to influence the nonstock organization, even if the person has no intent or interest in doing so, and even if the person has no knowledge of the nonstock organization (a phenomenon referred to here as “accidental control”). For example, according to the commenter, the

⁴ See also the representative test in section 4911(f)(2)(B)(i) for determining affiliated organizations.

representative test could unintentionally include an employer as a controlling person of an ATEO that two of the employer's employees established well before they became employees of the employer.

The representative test has an established history in tax law relating to tax-exempt organizations, appearing with minor variations in §1.512(b)-1(l)(4)(i)(b), section 4911(f)(2)(B)(i), §53.4958-4(a)(2)(ii)(B)(1)(iii), §1.414(c)-5(b), and the instructions to the Form 990 (for 2008 and subsequent years) defining "related organizations." The test may result in accidental control in some situations but is designed as a bright-line rule to avoid disputes over intent. However, to address the issue raised by the commenter, these proposed regulations permit a nonstock organization (or its putative controlling person or governmental entity) to qualify for an exception from control status if a director or trustee of the nonstock organization who is also a lower-level employee of the person or governmental entity (that is, not a trustee, director, or officer, or employee with the powers of a director or officer, of the person or governmental entity) is not acting as a representative of the person or governmental entity in his or her service with the nonstock organization. A nonstock organization that is relying on this exception must report that it is relying on the exception on the applicable Form 990 and provide details supporting the application of the exception.

III. Remuneration

A. In general

Consistent with section 4960(c)(3)(A), these proposed regulations define "remuneration" as wages under section 3401(a) (amounts generally 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). Remuneration does not include certain retirement benefits, including payments: that are contributions to or distributions from a trust described in section 401(a); under or to an annuity plan which, at the time of the payment, is a plan described in section 403(a); described in section 402(h)(1) and (2) if, at the time of the payment, it is reasonable to believe that the employee will be entitled to an exclusion under that section for the payment; under an arrangement to which section 408(p) applies; or under or to an eligible deferred compensation plan which, at the time of the 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). See section 3401(a)(12).

Remuneration also does not include an excess parachute payment but does include a parachute payment that is not an excess parachute payment.

In addition, these proposed regulations include in remuneration any amounts includible in gross income as compensation under section 7872 and related regulations. For example, under §1.7872-15(e)(1)(i), a below-market split-dollar loan between an employer and employee generally is a compensation-related loan and any imputed transfer from the employer to the employee generally is a payment of compensation. Although section 7872(f)(9) provides that no amount shall be withheld under Chapter 24 of the Code with respect to any amount treated as transferred or retransferred under section 7872(a) or received under section 7872(b), those amounts are “remuneration ... for services performed by an employee for his employer” within the meaning of section 3401(a) and are not specifically excluded from wages under section 3401(a). Thus, these amounts are remuneration as defined in section 4960(c)(3)(A). This analysis

applies by analogy to other remuneration for services performed by an employee that is included in wages under section 3401(a) but is nonetheless not subject to income tax withholding under section 3402.

One commenter requested that remuneration be read to include amounts paid by any related person or governmental entity only with respect to employment of the employee by the ATEO and not with respect to employment of the employee by the related person or government entity. Neither the statute nor the legislative history indicates that this was the intended reading. In defining “remuneration,” section 4960(c)(4)(A) provides that “remuneration of a covered employee by an [ATEO] shall include any remuneration paid with respect to employment of the employee by any related person or governmental entity.” In addition, the legislative history indicates an intent to align the tax treatment of certain executive compensation payments made by for-profit employers and tax-exempt employers. The commenter’s reading would be inconsistent with this intent, since section 162(m)(1) requires aggregation of amounts paid and proration of the resulting amount disallowed as a deduction if a covered employee of one member of an affiliated group is paid compensation by other members of the affiliated group. See §1.162-27(c)(1)(ii) and Prop. §1.162-33(c)(1)(ii). For these reasons, these proposed regulations do not limit the application of section 4960(c)(4)(A) to remuneration paid solely with respect to employment by the ATEO or for services rendered to the ATEO.

B. Remuneration related to medical services

Remuneration that is paid to a licensed medical professional for medical services is excluded from the definition of “remuneration” for purposes of section 4960. (See part

II.F. of this preamble, titled “Medical Services” for a further discussion of the scope of this exception.) When an employer compensates an employee for both medical services (including related services, such as medical recordkeeping) and other services, the employer must allocate remuneration paid to the employee between remuneration paid for medical services and remuneration paid for other services. These proposed regulations permit taxpayers to use a reasonable, good faith method to allocate remuneration between these two categories of services. For this purpose, taxpayers may rely on a reasonable allocation set forth in an employment agreement allocating remuneration between medical services and other services. If some or all of the remuneration is not reasonably allocated in an employment agreement, taxpayers must use another reasonable method of allocation. For example, allocating remuneration to medical services in the proportion that time spent providing medical services (determined based on records such as patient, insurance, Medicare/Medicaid billing records, or internal time reporting mechanisms) bears to the total hours the covered employee worked for the employer (including hours worked as an employee for all employers in a related group of organizations) would be a reasonable method. The Treasury Department and the IRS request comments providing examples of other reasonable methods of allocating remuneration between medical services and other services (or reasonable methods in particular circumstances).

C. When remuneration is treated as paid

These proposed regulations address when remuneration is treated as paid for purposes of section 4960. 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 within the meaning of section 457(f)(3)(B). 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 when there is no substantial risk of forfeiture of the rights to the remuneration is neither limited to remuneration that is otherwise subject to section 457(f) nor limited to amounts paid pursuant to a nonqualified deferred compensation arrangement. Rather, for purposes of section 4960(a), this timing rule applies to all forms of remuneration.

To make clear when remuneration that is never subject to a substantial risk of forfeiture is treated as paid, these proposed regulations provide that remuneration that is a “regular wage” within the meaning of §31.3402(g)-1(a)(ii) is treated as paid at actual or constructive payment. A “regular wage” is defined in §31.3402(g)-1(a)(ii) as remuneration “paid at a regular hourly, daily, or similar periodic rate (and not an overtime rate) for the current payroll period or at a predetermined fixed determinable amount for the current payroll period.” Remuneration that is not a regular wage but that is never subject to a substantial risk of forfeiture is treated as paid on the first date the service provider has a legally binding right to the payment.

With respect to payments that are at some time subject to a substantial risk of forfeiture, these proposed regulations refer to remuneration as “vested” when it is no longer subject to a substantial risk of forfeiture, and this remuneration is treated as paid when it vests. The Treasury Department and the IRS issued proposed regulations under section 457(f) in 2016 (81 FR 40548 (June 22, 2016)), upon which taxpayers may rely for periods before they are finalized. Under proposed §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. See Prop. §1.457-12(e)(3) for examples of the rules relating to substantial risk forfeiture. The Treasury Department and the IRS anticipate that the final regulations under section 4960 will adopt the definition of “substantial risk of forfeiture” in proposed §1.457-12(e)(1). 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.

Although requested by commenters, these proposed regulations do not provide a short-term deferral rule (such as the rules provided in §1.409A-1(b)(4) and proposed §1.457-12(d)(2)) that would change the date remuneration is treated as paid depending on the timing of vesting in relation to the timing of actual payment (typically of cash) to the employee. Allowing a short-term deferral similar to that allowed in §1.409A-1(b)(4) and proposed §1.457-12(d)(2) would permit the employer to determine the taxable year in which the amount is treated as paid and would be inconsistent with the statute. The Treasury Department and the IRS are concerned that providing this type of exception to the timing rule under section 4960 would permit ATEOs and related organizations to spread remuneration across multiple applicable years by delaying actual payment of an amount that is already vested and thus potentially avoid the tax. However, the Treasury Department and the IRS invite comments regarding any burdens that could be avoided through a short-term deferral rule and how such a rule could be designed to avoid permitting inappropriate avoidance of the tax.

While a short-term deferral exception might allow an employer to choose the taxable year in which a payment is made in order to avoid the excise tax, the Treasury Department and the IRS understand that for routine salary and other similar payments made for the final pay period of a calendar year, most employers do not distinguish between the amounts earned in the initial year and the amounts earned in the subsequent year that are both paid in the subsequent year. Because these regulations provide that remuneration that is a regular wage within the meaning of §31.3402(g)-1(a)(1)(ii) is treated as paid when actually or constructively paid, the employer will not need to determine amounts that vested in the initial year for purposes of section 4960. Thus, if a pay period ends December 26, 2020, but the salary for that period is not actually paid until January 2, 2021, then the salary is treated as paid in 2021 and the employer need not treat any amount as vested in 2020. But if the employee also vested in a bonus on December 26, 2020, that is actually paid on January 2, 2021, the bonus is treated as paid in 2020.

These proposed regulations provide that the amount of remuneration treated as paid generally is the present value of the remuneration on the date on which the covered employee vests in the right to payment of the remuneration. The employer must determine the present value using reasonable actuarial assumptions regarding the amount, time, and probability that the payment will be made. These proposed regulations do not provide rules for the determination of present value. However, an employer may determine the present value using the rules set forth in proposed §1.457-12(c)(1). The Treasury Department and the IRS anticipate that final regulations covering the determination of present value for purposes of section 4960 will be issued

when final regulations under section 457(f) are issued. In addition, to reduce the administrative burden for determining the present value of remuneration under a nonaccount balance plan described in §1.409A-1(c)(2)(i)(C) scheduled to be paid within 90 days after vesting (which would result in minimal discounting), the employer may treat the amount that is to be paid as the present value of the amount on the date of vesting. For example, an employer is not required to discount an annual bonus of \$10,000 that vests on December 31, 2020, and is scheduled to be paid on February 15, 2021, to reflect the delay in actual payment, but instead may treat \$10,000 of remuneration as paid in 2020. Until actually or constructively paid or otherwise includible in gross income of the employee, any amount treated as paid at vesting is referred to as “previously paid remuneration.”

D. Earnings and losses

These proposed regulations provide specific rules for the treatment of earnings and losses on previously paid remuneration, intended to minimize administrative burden. These proposed regulations provide that net earnings on previously paid remuneration are treated as vested (and therefore paid) on the last day of the applicable year in which they are accrued unless otherwise actually or constructively paid before that date. For example, the present value of vested remuneration accrued to an employee’s account under an account balance plan described in §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 accrued to the employee’s account and, until subsequently actually or constructively paid, is treated as previously paid remuneration. In addition, at the end of

each applicable year in which there is this type of 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 application of a predetermined actual investment or a reasonable market interest rate) is treated as remuneration paid in that applicable year.⁵

Similarly, the present value of a vested, fixed amount of remuneration under a nonaccount balance plan described in §1.409A-1(c)(2)(i)(C) is treated as paid on the date of vesting and subsequently treated as previously paid remuneration until actually or constructively paid. In addition, at the end of each applicable year in which there is this type of previously paid remuneration allocable to a covered employee, the net increase in the present value of that amount during the year due solely to the passage of time constitutes earnings and is treated as remuneration paid. For this purpose, earnings and losses from one plan or arrangement are aggregated with earnings and losses from any other plan or arrangement in which the employee participates that is provided by the same employer, resulting in an individual amount of remuneration paid by each employer and separate carryover of any net losses (but no carryover of 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. These proposed regulations further illustrate the operation of these rules through examples.

⁵This remuneration is then treated as previously paid remuneration for subsequent applicable years until actually or constructively paid.

E. Request for a grandfather rule

Commenters requested a “grandfather” rule for section 4960 similar to the grandfather rule under section 13601 of TCJA, which amended section 162(m). Section 13601(e) of TCJA provides that the amendments to section 162(m) are effective for taxable years beginning after December 31, 2017, unless remuneration is provided pursuant to a written binding contract that was in effect on November 2, 2017, and that was not modified in any material respect on or after December 31, 2017. Section 13602(c) of TCJA added section 4960 to the Code, but it did not provide for a grandfather rule and there is no indication in the legislative history that Congress intended to adopt one. In addition, notwithstanding the suggestion of one commenter, the Treasury Department and the IRS do not agree that the regulatory authority provided in section 4960(d) to prevent avoidance of the tax is applicable to the adoption of a grandfather rule. A rule permitting the exclusion of certain amounts from remuneration would not prevent taxpayer abuse of failing to report and pay the applicable tax. Accordingly, these proposed regulations do not provide a grandfather rule.

However, these proposed regulations provide rules that have the effect of grandfathering certain compensation. The proposed regulations provide that any nonqualified deferred compensation that vested prior to the first day of the first taxable year of the ATEO beginning after December 31, 2017, is not considered remuneration for purposes of section 4960. Specifically, these proposed regulations provide that any vested remuneration, including vested but unpaid earnings accrued on deferred amounts, that is treated as paid before the effective date of section 4960 (January 1,

2018, for a calendar year employer) is not subject to the excise tax imposed under section 4960(a)(1). All earnings on that remuneration that accrue or vest after the effective date, however, are treated as remuneration paid for purposes of section 4960(a)(1).

Similarly, for an employee who has vested deferred compensation from years prior to the taxable year in which the employee first became a covered employee, these proposed regulations provide that vested remuneration (including vested but unpaid earnings) that would have been treated as remuneration paid for a taxable year before the taxable year in which an employee first became a covered employee under section 4960 is not remuneration subject to the excise tax imposed by section 4960(a)(1) for the first taxable year in which the employee becomes a covered employee or any subsequent year. However, subsequent earnings that accrue on those vested amounts while the employee is a covered employee may be subject to the excise tax imposed under section 4960(a)(1).

One commenter requested that, for determining when remuneration is paid for purposes of section 4960, taxpayers be permitted to allocate ratably over the vesting period benefit amounts accruing under section 457(f) plans and subject to “cliff vesting” (generally referring to amounts accruing based on services performed over a period of time with the right to the entire amount vesting only at the end of that period). The commenter reasoned that the vesting period may span many years (including years prior to the date that section 4960 first applies to the employer) and therefore only the amount accrued for each year, regardless of whether it is vested, should be treated as paid for purposes of section 4960. Additionally, the commenter observed that treating

amounts that cliff vest as paid at vesting increases the likelihood that remuneration treated as paid to the employee will exceed the \$1 million threshold for that taxable year. Nonetheless, because the flush language of section 4960(a) provides explicitly that remuneration is treated as paid at vesting as determined under section 457(f)(3)(B) and there is nothing in section 457(f)(3)(B) that would permit such a ratable allocation rule, this suggestion is not incorporated into these proposed regulations.

One commenter requested relief from sections 409A and 457(f) so that affected taxpayers can delay vesting or payment of amounts that, as of November 2, 2017, were subject to a legally binding obligation to be paid in the future, to the extent necessary to avoid application of section 4960. Because the timing of payment of remuneration under section 4960 is based on the vesting date, the delay in an actual or constructive payment date generally will not affect when that remuneration is treated as paid for purposes of section 4960. However, an extension of a vesting period may have consequences both with respect to when remuneration is treated as paid under section 4960 and under section 457(f) and section 409A. The regulations under section 409A and the proposed regulations under section 457(f) impose limitations on the extension of the vesting period applicable to deferrals of compensation. Under those rules, in general, an amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the present value of the amount subject to a substantial risk of forfeiture is materially greater than the present value of the amount the recipient otherwise could have elected to receive absent such risk of forfeiture. See §1.409A-1(d)(1) and proposed §1.457-12(e)(2). With respect to section 4960, the

statute does not provide for a grandfathering rule or otherwise provide an exception to the application of section 457(f)(3)(A) and its definition of a “substantial risk of forfeiture” for purposes of determining the timing of payments. In addition, it is not appropriate to waive the otherwise applicable definition of “substantial risk of forfeiture,” which only recognizes extensions of vesting periods for which there is a rational economic basis (disregarding tax consequences) for purposes of section 4960. Accordingly, these proposed regulations do not adopt this suggestion.

F. Remuneration paid to a covered employee for which a deduction is disallowed under section 162(m)

Consistent with section 4960(c)(6), these proposed regulations provide that remuneration for which a deduction is disallowed under section 162(m) is not treated as remuneration paid to a covered employee. Thus, remuneration that is paid to a covered employee of an ATEO who is also a covered employee of a related “publicly held corporation” or an applicable individual of a related “covered health insurance provider” (as defined in section 162(m)(2) and (m)(6)(C), respectively), for which a deduction is disallowed under section 162(m), generally is not treated as remuneration for purposes of section 4960. However, that remuneration is taken into account for purposes of determining the ATEO’s five highest-compensated employees. See section II.E.1. of this preamble, titled “In General.”

In some circumstances, it may not be known at the time remuneration is treated as paid to a covered employee of the ATEO whether a deduction for such remuneration will be disallowed under section 162(m). For example, for purposes of section 4960(a)(1), nonqualified deferred compensation is treated as remuneration paid when

the right to it vests (see section III.C of this preamble, titled “When Remuneration is Treated as Paid”). Whether a deduction for payment of the compensation would be precluded by section 162(m) may not be known until a subsequent taxable year, since the timing of an employer’s otherwise available deduction for a payment of deferred compensation is delayed until the amount is includible in the employee’s gross income, which is generally when the amount is actually or constructively paid to the employee.

A second example includes the situation in which a covered employee of an ATEO becomes a covered employee of a related publicly held corporation or an applicable individual of a related covered health insurance provider after the taxable year for which an amount has been treated as excess remuneration under section 4960(a), but before the taxable year in which the remuneration is deductible (subject to the disallowance under section 162(m)). This may occur because, at the time the remuneration is treated as paid, the covered employee of the ATEO did not meet the definition of “covered employee” under section 162(m)(3) or “applicable individual” under section 162(m)(6)(F) or because the related organization did not meet the definition of “publicly held corporation” under section 162(m)(2) or “covered health insurance provider” under section 162(m)(6)(C). Further, the present value of a future payment that is contingent on a separation from employment may be taken into account for purposes of determining whether an excess parachute payment is made, but when the payment is made in a subsequent taxable year, the corresponding deduction may be disallowed under section 162(m). (See section IV. of this preamble, titled Excess Parachute Payments). In these circumstances if, after including an amount in remuneration under section 4960, it is determined that section 162(m) disallows a

deduction for that remuneration for a subsequent taxable year, a taxpayer may file a refund claim for the excise tax paid as a result of including the amount in remuneration, provided the period for making a refund claim has not expired.

In certain circumstances, however, it may not be known until after the period for making a refund claim has expired whether an amount that has been treated as excess remuneration is subject to the deduction disallowance under section 162(m). These proposed regulations do not address the coordination of sections 4960 and 162(m) in these circumstances, but instead this preamble describes possible approaches for future regulations coordinating these provisions and requests comments.

One possible approach is to permit the employer to exclude an amount from remuneration if the amount may reasonably be expected to be disallowed as a deduction under section 162(m) for a subsequent taxable year. Under this approach, for purposes of determining whether it is reasonably expected that an amount will be disallowed under section 162(m), the employer would be required to assume that remuneration is paid pursuant to the terms of the plan or arrangement under which the compensation is deferred, as in effect on the last day of the taxable year for which the amount is treated as remuneration paid. The Treasury Department and the IRS anticipate that this approach would permit this assumption only with respect to an organization that was a publicly held corporation or covered health insurance provider at the time the remuneration was treated as paid for purposes of section 4960 and only with respect to an employee that for that taxable year was a covered employee or applicable individual under section 162(m). In other words, the organization could not assume either that it would become a publicly held corporation or covered health

insurance provider by the time the amount became deductible but for the application of section 162(m) or that an individual who was not a covered employee or applicable individual under section 162(m) would become one by the time the amount became deductible but for the application of section 162(m). The Treasury Department and the IRS request comments on this approach, including:

- Whether it should be assumed that no other remuneration will be paid to the covered employee in the year the amount is otherwise deductible but for section 162(m) and, if not, how to account for other payments subject to section 162(m). For example, how to address ordering of payments subject to the deduction limitation under section 162(m).
- Whether, in determining when amounts will be paid as part of applying this approach, the potential for payment to be accelerated based on death, disability, change in control, unforeseeable emergencies, or other events outside of the control of the individual should be disregarded.
- Whether this approach should be available when a plan or arrangement provides for different forms of payment and, if so, whether it should be assumed that amounts will be paid in the most rapid form in these circumstances (for example, if a plan may pay either a lump sum or installments depending on the particular payment event, whether it should be assumed that the amount will be paid in a lump sum).
- Whether the assumption provided in proposed §1.457-12(c)(1)(ii)(C)(2), which provides that a separation from employment will occur no later than five years from the vesting date, should be adopted to determine when the deduction

limitation under section 162(m) is reasonably expected to apply and, if not, what assumptions should be used with respect to payments due upon separation from employment.

- Whether, in circumstances in which payments are made upon the occurrence of an event other than separation from employment and that payment event has not yet occurred, it is reasonable to assume that the section 162(m) deduction limitation will apply to amounts that are payable upon the occurrence of such a payment event and when such a payment event should be deemed to occur.

Comments are also requested on how to treat an amount that is reasonably determined to be subject to the deduction limitation under section 162(m), but for which the deduction is not subsequently limited. For example, a taxpayer may reasonably determine that the amount that is treated as paid for a taxable year for purposes of section 4960 will exceed the section 162(m) threshold for the taxable year when it is paid, but the amount that is ultimately included in the employee's gross income (together with any other amount that is potentially subject to section 162(m) for the year) may not exceed the 162(m) threshold in that year due to, for example, investment losses.

A second possible approach to address these circumstances is to permit an employer to offset remuneration subject to section 4960 in a later taxable year by an amount equal to the amount that was treated as excess remuneration under section 4960 in a previous taxable year for which the deduction is subsequently disallowed under section 162(m). This approach would only benefit employers that pay excess remuneration in subsequent years.

The Treasury Department and the IRS request comments on these potential approaches, including how each might be offered as an alternative, and any other approach that may be helpful in coordinating sections 4960 and 162(m).

IV. 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. These proposed regulations refer to this amount as “excess remuneration.” Consistent with section 4960(a)(1), the \$1 million threshold is not adjusted for inflation. An amount subject to tax under section 4960(a)(2) as an excess parachute payment is not subject to tax under section 4960(a)(1) as excess remuneration.

As provided in section 4960(c)(4)(C), if an individual performs services as an employee for two or more related organizations during the applicable year, one or more of which is an ATEO, each employer is liable for its proportional share of the excise tax. These proposed regulations provide rules for allocating liability for the excise tax among the employers. For this purpose, remuneration that is paid by a separate organization (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 a further discussion of when amounts are treated as paid on behalf of an ATEO, see part VI of this preamble, titled “Calculation, Reporting, and Payment of the Tax.”

V. Excess Parachute Payments

A. In general

Section 4960(a)(2) imposes an excise tax on any excess parachute payment. Section 4960(c)(5)(A) provides that “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 “parachute payment” means any payment in the nature of compensation to (or for the benefit of) a covered employee if the payment is contingent on the employee’s separation from employment with the employer and 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 3-times the base amount. Under section 4960(c)(5)(C), certain retirement plan payments, certain payments to licensed medical professionals, and payments to an individual who is not a “highly compensated employee” (HCE) as defined in section 414(q) are not excess parachute payments.⁶

The excess parachute payment rules under section 4960 are modeled after section 280G, but section 4960(c)(5)(B) defines “parachute payment” differently than section 280G(b)(2). The section 4960 definition refers to payments contingent on an employee’s separation from employment, whereas the section 280G definition refers to payments contingent on a change in the ownership or effective control of a corporation

⁶ 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 2018-83 (2018-47 I.R.B. 774) and Notice 2019-59 (2019-47 I.R.B. 1091), provide that the inflation-adjusted amounts for 2019 and 2020 are \$125,000 and \$130,000, 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.

(or in the ownership of a substantial portion of the assets of the corporation). While these proposed regulations incorporate many of the concepts found in the rules under §1.280G-1, with modifications to reflect the statutory differences between sections 280G and 4960, they do not incorporate other rules under §1.280G-1 because those rules address issues that do not arise under section 4960. In addition, many provisions in these proposed regulations do not have parallel rules under §1.280G-1 because they address issues that arise under section 4960, but not under section 280G.

The following sections provide an overview of the guidance in these proposed regulations for purposes of calculating the excise tax imposed under section 4960(a)(2), noting certain similarities and differences between these proposed regulations and the rules under §1.280G-1.

B. Definitions related to excess parachute payments

These proposed regulations define “excess parachute payment” and the term “parachute payment” for purposes of section 4960. Any payment in the nature of compensation made by an ATEO (or its predecessor or related organization) to a covered employee that is contingent on the employee’s separation from employment is taken into account for purposes of the parachute payment calculation, assuming no exclusion applies. Those combined payments constitute a parachute payment if the aggregate present value of all such payments made to an individual equals or exceeds 3-times the individual’s base amount. A parachute payment is an excess parachute payment to the extent it exceeds one-times the individual’s base amount allocated to the payment.

These proposed regulations define a “payment in the nature of compensation” based on §1.280G-1, Q/A–11 and Q/A–14. In general, any payment arising out of an employment relationship is a payment in the nature of compensation. A payment in the nature of compensation is reduced, however, by any consideration paid by the covered employee in exchange for the payment.

C. Payments contingent on a separation from employment

1. In General

Although section 4960 does not define what it means for a payment to be contingent on a separation from employment, these proposed regulations generally treat a payment as contingent on an employee’s separation from employment only if there is an involuntary separation from employment. If the payment is subject to a substantial risk of forfeiture (defined in a manner consistent with section 457(f)) at the time of an involuntary separation from employment, and the separation causes the risk of forfeiture to lapse, the payment is contingent on separation from employment.

2. Requirement of Involuntary Separation from Employment

Separation from employment (whether voluntary or involuntary) is often used in compensation arrangements as a trigger to pay vested compensation. For example, it is typical for a nonqualified deferred compensation plan to provide that a payment or a series of payments will be made or begin upon a separation from employment, including separation from employment resulting from death or disability. The vested amounts that are to be paid after a separation from employment generally are not treated as contingent on a separation from employment because the amounts will never be subject to forfeiture or otherwise not paid (even if an employee does not voluntarily or involuntarily terminate employment during the employee’s lifetime, the payments will be

made upon the employee's death). In these cases, the separation from employment functions only as a payment timing event and is neither a contingent event that may not occur nor a precondition to entitlement to the payment.

3. Definition of "Involuntary Separation from Employment"

If an amount is payable solely upon an involuntary separation from employment, then it is a payment contingent on an event that may not occur and that is a precondition to entitlement to the payment. The definition of an "involuntary separation from employment" set forth in these proposed regulations is modeled after the definition of an "involuntary separation from service" in §1.409A-1(n)(1), which also was the model for the definition of an "involuntary severance from employment" under proposed §1.457-11(d)(2). A separation from employment for good reason is treated as an involuntary separation from employment for purposes of section 4960 if certain conditions are met. For this purpose, these proposed regulations generally adopt the standards set forth in §1.409A-1(n)(2) and proposed §1.457-11(d)(2)(ii).

In addition, these proposed regulations generally adopt 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, these proposed regulations adopt the standards of §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, an anticipated reduction in the level of services of less than 50 percent is not treated as a separation from employment, and the treatment of

an anticipated reduction between these two levels will depend on the facts and circumstances. The measurement of the anticipated reduction in the level of services is based on the average level of bona fide services performed over the immediately preceding three years (or shorter period for an employee employed for less than three full prior years). However, the proposed regulations do not adopt the rule of §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. Finally, because the section 409A regulations do not provide a standard for determining when an involuntary change of status from employee to independent contractor results in a separation from employment, the Treasury Department and the IRS request comments on whether additional guidance is needed on this issue.

4. When a Payment Is Contingent on Separation from Employment

In defining when a payment is contingent on separation from employment, these proposed regulations do not focus solely on whether the payment would not have been made but for a separation from employment, but instead also take into consideration whether the separation from employment accelerates the lapse of the substantial risk of forfeiture with respect to the right to payment or accelerates the right to payment. Generally, if the lapse of a substantial risk of forfeiture is accelerated or payment is accelerated as a result of an involuntary separation from employment (such as a payment that otherwise would have vested and been paid had the employee remained employed for a subsequent period of time), then the value of the accelerated payment plus the value of the lapse of the substantial risk of forfeiture is treated as contingent on a separation from employment (since the employer would not have provided the increased value in the absence of an involuntary separation from employment).

However, if the lapse of the substantial risk of forfeiture is dependent on an event other than the performance of services, such as the attainment of a performance goal, and if that event does not occur prior to the employee's separation from employment, but the payment vests due to the employee's involuntary separation from employment, then the full amount of the payment is treated as contingent on the 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 not contingent on a separation from employment (since the right to the payment is not triggered by the separation from employment). However, the increased value of an accelerated payment of a previously vested amount resulting from an involuntary separation from employment is treated as a payment contingent on a separation from employment. These proposed regulations adopt the rules of §1.280G-1, Q/A-24(c) for purposes of determining the value of accelerated vesting.

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 these proposed regulations, "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.

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 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 regardless of whether the payment(s) may be considered reasonable compensation for services provided. Similarly, if a covenant not to compete negotiated as part of an employment agreement provides for a benefit upon an involuntary separation, then the benefit is contingent on a separation from employment regardless of whether the payment may be considered reasonable compensation for services provided. This treatment is different from the treatment of payments made under a covenant not to compete in §§1.280G-1, Q/A-9, Q/A-40(b), and Q/A-42(b), under which payments made under a covenant not to compete may be treated as reasonable compensation for services (and thus excluded from the calculation of parachute payments) even if the payments would not have been made in the absence of a change in control. The Treasury Department and the IRS have concluded that the different treatment is warranted because in these cases a covenant not to compete is integrally related to the involuntary separation from employment, whereas a covenant not to compete generally is not integrally related to a change in ownership or control.

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, 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 separation from employment may affect the time of, but not the right to, the payment (although the value of an acceleration of the payment may be contingent on a separation from employment). 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. In contrast, a payment under a window program described in §1.409A-1(b)(9)(vi) is contingent on a separation from employment.

Unlike Q/A–25 and Q/A–26 of §1.280G-1, these proposed regulations do 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 discussed further below, 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, these proposed regulations do not provide a rule similar to the one found in §1.280G-1, Q/A–9 (exempting reasonable compensation for services rendered on or after a change in ownership or control from the definition of “parachute payment”), that would exclude reasonable compensation for services provided after a separation from employment. In most cases, the issue of whether payments made after a separation from employment are reasonable compensation for services will not arise

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 an involuntary 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. Nonetheless, as discussed previously in this section of this preamble, these proposed regulations provide that an agreement under which the employee must refrain from performing services (for example, a covenant not to compete) is not treated as an agreement for the performance of services. See the discussion in section V.B.4 of this preamble.

Notwithstanding the foregoing, if the facts and circumstances demonstrate that either vesting or payment of an amount (whether before or after an 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 was therefore 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 was therefore contingent on the employee's separation from employment.

The Treasury Department and the IRS request comments on whether there are types of payments made in connection with separation from employment other than those described in the preceding paragraphs and the extent to which the final regulations under section 4960 should be modified to ensure appropriate classification of those payments as contingent or not contingent on separation from employment.

D. Three-times-base-amount test

Section 4960(c)(5) provides rules for determining the tax on any excess parachute payment imposed under section 4960(a)(2). 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 3-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 section 280G(d)(3) and (4) apply for purposes of present value determinations. Section 280G(b)(3) provides that “base amount” means an individual’s annualized includible compensation for the 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.

These proposed regulations provide that the “base amount” is the average annual compensation as an employee of the ATEO (including services performed as an employee of a predecessor or related organization) for the taxable years in the “base period” and that the base period is the five most recent taxable years during which the individual was an employee of the ATEO (or predecessor or related organization) or the portion of the five-year period during which the employee was an employee of the ATEO (or predecessor or related organization).

These proposed regulations provide rules for determining whether a payment is an excess parachute payment, including rules for applying the 3-times-base-amount test. Under the proposed regulations, payments in the nature of compensation that are contingent on a separation from employment are parachute payments if the aggregate present value of the payments equals or exceeds 3-times the employee’s base amount. In addition, reasonable actuarial assumptions must be used to determine the aggregate present value of payments to be made in years subsequent to the year of separation from employment, and a special rule for the valuation of an obligation to provide health care benefits is proposed. These proposed regulations also provide that the discount rate to be used in determining aggregate present value is 120 percent of the applicable Federal rate under section 1274(d), compounded semi-annually. These proposed regulations further provide rules for determining the present value of a payment to be made in the future that is based on uncertain future events.

The rules proposed for determining the base amount, base period, and present value, including determining the present value of payments that are contingent on uncertain future events, are based on the rules under §1.280G-1, Q/A–30 through Q/A–36 (substituting an involuntary separation from employment for a change in control). These proposed regulations describe when a payment in the nature of compensation is considered made for purposes of section 4960(a)(2), based on the rules found in §1.280G-1, Q/A–11 through Q/A–14. Similar to §1.280G-1, Q/A–11, a payment in the nature of compensation generally is considered made in the same taxable year as the year in which the amount is includible in the employee’s gross income or, in the case of fringe benefits and other benefits excludible from income, in the year of receipt. In the case of taxable non-cash fringe benefits, these proposed regulations generally incorporate the income recognition timing rules found in Announcement 85-113 (1985-31 I.R.B. 31). Under these rules, for taxable non-cash fringe benefits provided in a calendar year, payment is considered made on any date or dates the employer chooses during the year (but not later than December 31) or, if provided during the last two months of the calendar year, during the subsequent year (subject to limitations).

These proposed regulations provide that the transfer of section 83 property generally 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, disregarding any election made by the employee under section 83(b) or (i). This rule is consistent with the rules provided under §1.280G-1, Q/A–12(a). In addition, similar to the rules provided under §1.280G-1, Q/A–13(a), these proposed regulations generally provide that stock options and stock appreciation rights are treated as

property transferred on the date of vesting (regardless of whether the option has a “readily ascertainable value” as defined in §1.83-7(b)). For purposes of determining the timing and amount of any payment related to an option or a stock appreciation right, the principles of §1.280G-1, Q/A–13 and Rev. Proc. 2003-68 (2003-2 C.B. 398) apply.

E. Computation of excess parachute payments

Consistent with section 4960(c)(5)(A), these proposed regulations provide 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 the payment. 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 to be made to the covered employee. The rules on allocation of the base amount provided in these proposed regulations are based on §1.280G-1, Q/A–38.

VI. Calculation, Reporting, and Payment of the Tax

Some ATEOs (and any related non-ATEO organizations) will not be affected by section 4960 because they do not pay any employee sufficient remuneration to trigger the tax. There can be no excess remuneration under section 4960(a)(1) if an ATEO (together with any related organization) does not pay more than \$1 million of remuneration to any employee for a taxable year, and there can be no excess parachute payment under section 4960(a)(2) if the employer does not have any HCEs under section 414(q)⁷ for the taxable year. In these cases, no excise tax under section 4960 is owed.

⁷ See footnote 8.

These proposed regulations provide rules regarding the entity that is liable for the excise tax under section 4960 and how that excise tax is calculated. These proposed regulations provide that the employer, as determined under section 3401(d), without regard to paragraph (d)(1) or (d)(2), is liable for the excise tax imposed under section 4960. Pursuant to section 4960(d), a payment by the employer may be treated as remuneration or a parachute payment if, based on the facts and circumstances, the payment is structured such that it has the effect of avoiding the tax applicable under section 4960. For example, the excise tax under section 4960 would apply if it would otherwise apply with respect to an individual who is an employee of the ATEO or related organization but who is incorrectly classified as an independent contractor. Similarly, the excise tax under section 4960 would apply to an amount paid to a limited liability company or other entity owned all or in part by an employee (or owned by another entity unrelated to the ATEO or related organization) for services performed by an employee of the ATEO or related organization if the arrangement would otherwise have the effect of avoiding the tax applicable under section 4960. For a further discussion of the definition of “employer” under these proposed regulations, see section II.D. of this preamble, titled “Employer.”

A. Calculation of tax on excess remuneration

An individual may perform services as an employee of an ATEO and as an employee of one or more related organizations during the same applicable year, 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, these proposed regulations provide rules for allocating liability for the excise tax among

the related 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 proportional share of the excise tax. In contrast, a payment for the services of an individual who performs services only as an employee of an ATEO, that is made by one or more other organizations (whether those organizations are related to the ATEO or not), is treated as remuneration paid by the ATEO and thus is aggregated with any remuneration paid directly by the ATEO (and the related liability is not allocated to the other organizations). If a covered employee is employed by one employer when the legally binding right to the remuneration is granted and employed by a different employer at vesting, then the covered employee's employer at vesting is treated as paying the remuneration, provided the employment relationship is bona fide and not a means to avoid tax under section 4960. The Treasury Department and the IRS request comments on whether there is a more appropriate approach to allocating liability for the excise tax where services performed for more than one employer during a vesting period are credited towards a vesting requirement based on the performance of services.

Consistent with the discussion of short applicable years in part II.B. of this preamble, titled "Applicable year," a related organization may become related (or may cease to be related) during the applicable year, in which case only remuneration the related organization pays (or is treated as paying due to vesting) to the ATEO's covered employee during the portion of the applicable year that it is a related organization is treated as paid by the ATEO for the taxable year, as provided in section 4960(c)(4)(A).

If an employee is a covered employee of more than one ATEO, these proposed regulations provide that each ATEO calculates its liability under section 4960(a)(1), taking into account remuneration paid to the employee by the organizations to which it is related. These proposed regulations also provide that, rather than owing tax as both an ATEO and a related organization for the same remuneration paid to a covered employee, each 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. These proposed regulations also provide rules for determining liability when a related organization has a termination of ATEO status.

In order to calculate its liability for the tax on excess remuneration, an ATEO may take the following steps:

Step 1: Calculate total remuneration paid (other than any excess parachute payment) to each covered employee, including remuneration from all related organizations. The total tax liability for the ATEO and related organizations with respect to each covered employee is 21 percent (for 2020) of the total remuneration paid to the covered employee that exceeds \$1 million;

Step 2: Calculate the share of the liability for each employer of the covered employee as the portion of the total tax liability that bears the same ratio to the total tax liability as the ratio of the amount of remuneration paid by the employer to the total remuneration calculated in step 1;

Step 3: Inform each related organization of its share of the liability calculated in step 2;

Step 4: Obtain information on the ATEO's share of the liability as a related organization for any covered employee of another ATEO. If the ATEO is a related organization with respect to more than one other ATEO, treat the ATEO's highest share of the liability as a related organization as its liability as a related organization for the covered employee; and

Step 5: Compare the ATEO's liability as an ATEO in step 2 to its share of the liability as a related organization under step 4 for each of the ATEO's covered employees. The ATEO's share of the liability is, and the ATEO reports, the greater of the share calculated under step 2 or step 4.

B. Calculation of tax on an excess parachute payment

With respect to the calculation of, and liability for, the tax on excess parachute payments, these proposed regulations differ in one respect from the guidance provided in Q/A-1 of Notice 2019-09. Notice 2019-09 provided that an ATEO or related organization may be liable for the tax on an excess parachute payment based on the aggregate parachute payments made by the ATEO and its related organizations, including parachute payments based on separation from employment from a related organization. These proposed regulations provide that only an excess parachute payment paid by an ATEO is subject to the excise tax on excess parachute payments. However, consistent with the provision in section 4960(c)(5)(D) that rules similar to section 280G(b)(3) apply for purposes of determining the base amount under section 4960, payments from related organizations that are not ATEOs are considered for purposes of determining the base amount and total payments in the nature of compensation that are contingent on the covered employee's separation from

employment with the employer. See §1.280G-1, Q/A–34. Generally, this means that a covered employee’s base amount calculation includes remuneration from all ATEOs and related organizations, and that a covered employee’s parachute payment calculation includes all payments (made from all ATEOs and related organizations) that are contingent on the employee’s involuntary separation from employment. However, only ATEOs are subject to the excise tax on excess parachute payments they make to a covered employee. A non-ATEO that pays an amount that would otherwise be an excess parachute payment is not subject to the excise tax. These proposed regulations further provide that, based on the facts and circumstances, the Commissioner may reallocate excess parachute payments to an ATEO if it is determined that excess parachute payments were made by a non-ATEO for the purpose of avoiding the tax under section 4960.

In order to calculate its liability for the tax on excess parachute payments, an ATEO may take the following steps:

Step 1: Determine whether a covered employee is entitled to receive payments in the nature of compensation that are contingent on an involuntary separation from employment (contingent payments) and are not excluded from the definition of “excess parachute payment”;

Step 2: Calculate the total aggregate present value of the contingent payments, taking into account the rules that apply when an involuntary separation from employment accelerates the timing of a payment or the 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 whether the contingent payments are parachute payments. Contingent payments are parachute payments if their total aggregate present value equals or exceeds an amount equal to 3-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; and

Step 6: Calculate the amount of excise tax imposed under section 4960(a)(2). The excise tax is the amount equal to the product of the rate of tax under section 11 (21 percent for 2020) and the sum of any excess parachute payments paid by an ATEO or related organization during a taxable year to the covered employee.

C. Reporting and payment of the tax

On April 9, 2019, the Treasury Department and the IRS issued final regulations under sections 6011 and 6071 (§§53.6011-1 and 53.6071-1, T.D. 9855, 84 FR 14008) to address reporting and the due date for paying the section 4960 tax. Those final 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. Those final regulations provide that the reporting and payment of any applicable taxes are due when payments of chapter 42 taxes are ordinarily 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 returns and making payments⁸ that generally applies.

These proposed regulations provide that 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. These proposed regulations also provide that an employer may elect to prepay the excise tax imposed under section 4960(a)(2) for excess parachute payments in the year of separation from employment or any taxable year prior to the year in which the parachute payment is actually paid. This prepayment rule for the tax applicable to excess parachute payments is similar to the rule in §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 the section 4960 excise tax is subject to quarterly payments of estimated tax under section 6655. Because section 6655 has not been amended to include section 4960, no quarterly payments of estimated section 4960 excise tax are required under section 6655.

VII. Proposed Applicability Date

These regulations are proposed to apply to taxable years beginning on or after the date the final regulations are published in the Federal Register. The Treasury Department and the IRS understand that the date during a calendar year on which final

⁸ The tentative tax, an estimate, must be paid by the due date of Form 4720 without extensions. and may be paid with Form 8868, "Application for Automatic Extension of Time To File an Exempt Organization Return."

regulations are issued may affect the time an ATEO and its related organization(s) will have to familiarize themselves with the regulations and to respond with adjustments to compensation structures or other adjustments. The Treasury Department and the IRS will take this into account when issuing the final regulations, but also request comments on the burdens anticipated and the timeframe expected to be necessary to implement the final regulations (taking into account that the statutory provisions are already effective).

The guidance provided in these proposed regulations generally is consistent with the guidance provided in Notice 2019-09. However, in certain instances these proposed regulations modify the guidance provided in Notice 2019-09. Until the applicability date of the final regulations, taxpayers may rely on the guidance provided in Notice 2019-09 or, alternatively, on the guidance provided in these proposed regulations, including for periods prior to **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Taxpayers may also base their positions upon a reasonable, good faith interpretation of the statute that includes consideration of any relevant legislative history. Whether a taxpayer's position that is inconsistent with Notice 2019-09 or these proposed regulations constitutes a reasonable, good faith 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, the preamble to Notice 2019-09 describes certain positions that the Treasury Department and the IRS have concluded are not consistent with a reasonable, good faith interpretation of the

statutory language, and these proposed regulations reflect this view. Specifically, the following positions will continue to be treated as inconsistent with a reasonable, good faith interpretation of the statutory language:

(1) Remuneration paid by a separate employer that is a related for-profit or governmental entity (other than an ATEO). The position 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, is not consistent with a reasonable, good faith interpretation of the statutory language. There is no statutory support for 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) through (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), 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). Finally, 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.

(2) Continued treatment of a covered employee as a covered employee. The position that a covered employee ceases to be a covered employee after a certain period of time is not consistent with a reasonable, good faith interpretation of the statute. Although 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 during which the individual was not an active employee of the ATEO, neither Notice 2019-09 nor these proposed regulations adopt that suggestion because it is inconsistent with the statute.

(3) Remuneration for medical services for purposes of determining the five highest-compensated employees. The position that remuneration for medical services is taken into account for purposes of identifying the five highest-compensated employees is not consistent with a reasonable, good faith interpretation of the statute. As the Conference Report to TCJA 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. Rept. 115-466, at 494 (2017).

(4) Covered employees of a group of related organizations. The position that a group of related ATEOs may have only five highest-compensated employees among all of the related ATEOs is not consistent with a reasonable, good faith interpretation of

the statute. Section 4960 does not provide for such treatment. Further, to the extent section 4960 is analogous to the compensation deduction limitation under section 162(m), §1.162-27(c)(1)(ii) provides that 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.

Special Analyses

I. Regulatory Planning and Review

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The Executive Order 13771 designation for any final rule resulting from the proposed regulation will be informed by comments received. The preliminary Executive Order 13771 designation for this proposed rule is “regulatory.”

The proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated the proposed rulemaking as significant under section 1(c) of the Memorandum of Agreement. Accordingly, OMB has reviewed the proposed regulations.

A. Background

1. The excise tax under section 4960

Section 4960 was added to the Code by TCJA. Section 4960(a) subjects excess remuneration above \$1 million and excess parachute payments that an ATEO pays to a covered employee to an excise tax equal to the rate of tax imposed on corporations under section 11 (21 percent for 2020). Before TCJA, compensation paid by tax-exempt organizations was not subject to an excise tax, although section 4958 applies an excise tax to penalize excess benefit transactions in which an “applicable tax-exempt organization” (as defined in section 4958) provides a benefit to a disqualified person that exceeds the reasonable fair market value of the services received.

Section 4960 defines an “ATEO” as any organization which is exempt from taxation under section 501(a), is a farmers’ cooperative organization described in section 521(b)(1), has income excluded from taxation under section 115(1), or is a political organization described in section 527(e)(1). Covered employees of an ATEO include the five highest-compensated employees of the organization for the taxable year and any employee or former employee who was a covered employee of the organization (or predecessor) for any preceding taxable year beginning after December 31, 2016.

“Remuneration” means “wages” as defined in section 3401(a) (excluding designated Roth contributions) and includes amounts required to be included in gross income under section 457(f). Section 4960 excludes from remuneration any amount paid to a licensed medical professional for medical or veterinary services provided. Remuneration also includes payments with respect to employment of a covered employee by any person or government entity related to the ATEO. A person or

governmental entity is treated as related to the ATEO if that person or governmental entity controls, or is controlled by, the ATEO, is controlled by one or more persons which control the ATEO, is a “supported organization” (as defined in section 509(f)(3)) during the taxable year with respect to the ATEO, is a supporting organization described in section 509(a)(3) during the taxable year with respect to the ATEO, or in the case of an organization which is a voluntary employees’ beneficiary association (VEBA) under section 501(c)(9), established, maintains, or makes contribution to such VEBA.

2. Notice 2019-09 and the proposed regulations

Notice 2019-09 provides taxpayers with initial guidance on the application of section 4960, including that taxpayers may base their positions on a reasonable, good faith interpretation of the statute until further guidance is issued. These proposed regulations are largely based on Notice 2019-09 with changes in part addressing comments received.

The Treasury Department and the IRS received 14 comments in response to Notice 2019-09. The comments primarily discussed the treatment of employees of a related person who also provide services to the ATEO, suggesting various exceptions for such situations. Comments also addressed the possibility of a grandfather rule for compensation under prior arrangements, treatment of deferred compensation as remuneration, the definition of “control,” and which organizations are ATEOs.

B. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these regulations.

C. Affected entities

The proposed regulations affect an estimated 261,000 ATEOs and 77,000 non-ATEO related organizations of ATEOs that in historical filings report substantial executive compensation.⁹ Of the roughly 261,000 such ATEOs based on filings for tax year 2017, 239,000 are section 501(a) exempt organizations (including 23,000 private foundations), 19,000 are section 115 state and local instrumentalities, 2,000 are section 527 political organizations, 600 are exempt farmers' cooperative organizations described in section 521(b)(1), and 200 are federal instrumentalities.

D. Economic Analysis

This section describes the key economic effects of the provisions of these proposed regulations.

1. Clarifications

Most provisions of the proposed regulations clarify aspects of the excise tax imposed by section 4960, minimizing the burdens entities bear to comply with section 4960, and have little other economic impact. Clarifications reduce uncertainty, lowering the effort required to infer which organizations, employees, and payments are subject to the excise tax and the potential for conflict if entities and tax administrators interpret provisions differently. Examples of provisions of the proposed regulations that are primarily clarifications include the definition of "control," treatment of deferred compensation and vesting, and which organizations are ATEOs.

⁹ The methods and data used to estimate the number of affected entities are discussed in detail in the Paperwork Reduction Act special analysis.

2. “Volunteer” exceptions

Several commenters expressed concern that highly-paid employees of a non-ATEO performing services for a related ATEO without receiving compensation from the ATEO may be subject to the excise tax. To avoid the excise tax, individuals might cease performing such services, or ATEOs might dissolve their relationships with related non-ATEOs, reducing donations from related non-ATEOs.

The proposed regulations include exceptions to the definitions of “employee” and “covered employees” (specifically to the rules for determining the five highest compensated employees for purposes of identifying covered employees) to address such situations. With respect to the first exception, the regulations define “employee” consistent with section 3401(c), in particular adopting the rule that a director is not an employee in the capacity as a director and an officer performing minor or no services and not receiving any remuneration for those services is not an employee.

The general rule provides that employees of a related non-ATEO are not considered for purposes of determining the five highest-compensated employees if they are never employees of the ATEO. In addition, individuals who receive no remuneration (or grant of a legally binding right to remuneration) from the ATEO or a related organization cannot be among the ATEO’s five highest-compensated employees.

Under the exceptions, an ATEO’s five highest-compensated employees also exclude an employee of the ATEO who receives no remuneration from the ATEO and performs only limited services for the ATEO, which means that no more than 10 percent of total annual hours worked for the ATEO and related organizations are for services performed for the ATEO. An employee who performs fewer than 100 hours of services as an employee of an ATEO and its related ATEOs is treated as having worked less

than 10 percent of total hours for the ATEO and related ATEOs. An employee who is not compensated by an ATEO, related ATEO, or any taxable related organization controlled by the ATEO and who primarily (more than 50 percent of total hours worked) provides services to a related non-ATEO is also disregarded. Likewise, an employee is disregarded if an ATEO paid less than 10 percent of the employee's total remuneration for services performed for the ATEO and all related organizations. However, in the case of related ATEOs, if neither the ATEO nor any related ATEO paid more than 10 percent of the employee's total remuneration, then the ATEO that paid the highest percent of remuneration does not meet this exception.

Consider, for example, a corporate employee making \$2 million per year who spends 5 percent of her time (roughly one day each month) working for the corporation's foundation, a related ATEO, without receiving compensation from the ATEO and who would be a covered employee of the ATEO absent the exceptions. The value of the employee's services provided to the ATEO is roughly five percent of her salary, or \$100,000. Without the exceptions, her compensation in excess of \$1 million from the corporation, which is a related party of the foundation, is subject to a 21 percent excise tax, or \$210,000 in excise tax liability. The exceptions remove that liability and the incentive it provides to stop providing such services or to dissolve the relationship between the ATEO and the related organization.

The exceptions in the proposed regulations may have a substantial impact on donations relative to a no-action baseline, although the magnitude of the potential impact depends on how often the exceptions apply and on how responsive organizations and employees are to the excise tax, both of which are uncertain.

The exceptions apply only in particular circumstances: the employee must be employed by a related organization (typically an organization that controls or is controlled by the ATEO), the employee must be highly compensated, and the employee's work for the ATEO must be sufficiently minimal. Historically, many ATEOs report employees with compensation from related organizations. An estimated 8,500 ATEOs filing Form 990 in tax year 2017 reported both compensation of \$500,000 or more for any person and any compensation from related organizations. These ATEOs are estimated to have an average of 18 non-ATEO related organizations based on information reported on Form 990 Schedule R, yielding an estimated 154,000 non-ATEO related organizations, of which half, or 77,000, are estimated to employ a covered employee of the ATEO. The fraction of the 154,000 non-ATEO related organizations with employees to whom the exceptions apply (and who are thus not covered employees of the ATEO) is uncertain, but perhaps half the related organizations, or 77,000, have such an employee.

This entity count omits a substantial number of private foundations which may have employees who receive no compensation from the ATEO but who are highly compensated by related organizations, because while the ATEO count used in these estimates includes approximately 100 private foundations that have historically reported employee compensation of \$500,000 or more on Form 990-PF, Form 990-PF (unlike Form 990) does not include information on employee compensation received from related organizations. The exceptions are particularly likely to apply to donations to foundations related to non-ATEO businesses, as companies are highly likely to be related organizations of a company's foundation, many family foundations are controlled

by the same family that controls a private business, and executives of the related business often provide services to the foundation without payment from the foundation. Because of these facts, looking at pre-TCJA tax forms may underestimate the number of entities potentially affected by the exceptions. In the U.S. in 2015, there were about 2,000 company foundations responsible for \$5.5 billion in giving, and 42,000 family foundations.¹⁰ It is reasonable to assume that about half of these foundations, or 22,000, have a related business with an employee to whom the exceptions apply.

Under reasonable assumptions about the response of donated services to the excise tax, the exceptions restore substantial donations (transfers) of services that the excise tax would otherwise eliminate. Totaling both private foundations and other ATEOs, roughly 99,000 related organizations are estimated to have employees to whom the exceptions apply. If the excise tax would have reduced services that are donated under the exceptions by an average of just over \$5,000 per related organization, the total transfer reduction exceeds \$500 million.

Absent the exceptions, organizations may also avoid the excise tax by dissolving the relationship between the ATEO and non-ATEO, which may affect donations of money as well as services. Considering only corporate foundations and setting aside other ATEOs, if such dissolutions would lead to a two percent reduction in the \$5.5 billion in corporate giving that would otherwise take place through related foundations, the reduction exceeds \$100 million. The Treasury Department and the IRS request comments on the impact of the exceptions on the dissolution of relationships between ATEOs and related organizations.

¹⁰ <http://data.foundationcenter.org/>

It is plausible that the proposed regulations restore substantial economic activity relative to a no-action baseline, under which the excise tax would discourage highly-compensated employees of related non-ATEOs from providing services to a related ATEO without compensation from the ATEO and discourage relationships between ATEOs and non-ATEOs.

3. Summary

This analysis suggests that the proposed regulations will reduce compliance burden on affected entities by providing clarifications and, through the exceptions, increase services provided to ATEOs without compensation from the ATEO by a small but potentially economically significant amount (\$100 million or more), relative to a no-action baseline. The Treasury Department and the IRS request comments on the economic impact of these proposed regulations. In particular, comments that provide data, other evidence, or models that provide insight are requested.

II. Paperwork Reduction Act

The collections of information in these proposed regulations are in proposed §53.4960-1(d), (h), (i)(2) and (j); §53.4960-2(a), (c) and (d); and §53.4960-4(a) and (d). This information is required to determine an ATEO's "covered employees" as defined in section 4960(c)(2); to calculate remuneration in excess of \$1 million as described in section 4960(c)(3); to determine remuneration from related organizations and allocation of liability as described in section 4960(c)(4); and to determine any excess parachute payments to covered employees described in section 4960(c)(5).

The IRS intends that the burden of the collections of information will be reflected in the burden associated with Form 4720, under OMB approval number 1545-0047. The burden associated with Form 4720 is included in the aggregated burden estimates for

OMB control number 1545-0047. For purposes of the Paperwork Reduction Act, the Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations.

The expected burden for ATEOs as described in section 4960(c)(1) and related organizations as described in section 4960(c)(4)(B) is listed below:

Estimated number of respondents: 337,888

Estimated average annual burden hours per response: 0.20 hours (based on 66,509 total hours)

Estimated total annual burden: \$3,569,632 (2020)

Estimated frequency of collection: Annual

The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. Proposed revisions (if any) to these forms that reflect the information collections contained in the final regulations will be made available for public comment at <https://apps.irs.gov/app/picklist/list/draftTaxForms.html> and will not be finalized until after these forms have been approved by OMB under the PRA. Comments on these forms can be submitted at <https://www.irs.gov/forms-pubs/comment-on-tax-forms-and-publications>.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

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 return information are confidential, as required by 26 U.S.C. 6103.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities.

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) generally defines a “small entity” as (1) a proprietary firm meeting the size standards of the Small Business Administration (SBA) (13 CFR 121.201), (2) a nonprofit organization that is not dominant in its field, or (3) a small government jurisdiction with a population of less than 50,000. (States and individuals are not included in the definition of “small entity.”) The Treasury Department and IRS estimate that these proposed regulations will affect 324,000 small entities, 73,000 of which are proprietary firms meeting the size standards of the SBA and 251,000 of which are nonprofit organizations that are not dominant in their fields or small government jurisdictions with a population of less than 50,000.

The Treasury Department and IRS estimated the number of ATEOs, based primarily on Form 990 data for filers with at least one employee (and thus having a burden, at a minimum, of maintaining annual lists of covered employees), as 261,118, and the number of non-ATEO related organizations employing at least one covered employee of an ATEO as 76,770, for a total of 337,888 affected entities. The SBA defines a small business as an independent business having fewer than 500

employees. (See A Guide for Government Agencies, How to Comply with the Regulatory Flexibility Act, Appendix B¹¹). Tax data available to Treasury Department and IRS include employee counts for only half the affected entities, as employee counts are included on Form 990, but not on other forms including Form 990-EZ and 990-PF. An examination of tax data from 2016 shows that for filers for whom employee counts were available and who had at least one employee, 96.5 percent had fewer than 500 employees. Similarly, there are no bright lines in the available data to distinguish small nonprofit organizations that are not dominant in their field. An examination of non-tax data shows that a similar proportion, approximately 96 percent, of all incorporated cities, towns, and villages in 2014 had a population of less than 50,000, which may serve as a proxy for small government jurisdictions generally.¹² By applying the 96 percent estimate to all entities affected by section 4960, the Treasury Department and IRS estimate that 324,000 small entities are affected by these regulations.

Section 4960 imposes the excise tax on ATEOs and their related organizations to the extent they pay certain compensation to a covered employee. Because covered employee status is permanent, every ATEO must determine its five highest-compensated employees for the taxable year – even if the ATEO is not subject to the tax for that taxable year – and maintain a list of covered employees. Accordingly, the proposed rules likely will affect a substantial number of small entities, especially nonprofit entities that are not dominant in their fields.

¹¹ <https://advocacy.sba.gov/2017/08/31/a-guide-for-government-agencies-how-to-comply-with-the-regulatory-flexibility-act/>

¹² See <https://www.statista.com/statistics/241695/number-of-us-cities-towns-villages-by-population-size/>

The Treasury Department and the IRS estimate that vast majority of ATEOs, particularly small ATEOs, can determine their five highest-compensated employees for the taxable year under the method provided in the proposed rule very quickly and at negligible cost using information already collected in the normal course of business. The time necessary to determine an ATEO's five highest-compensated employees is positively correlated with the size of the entity (that is, the smaller the entity, the less time such a determination should take). Larger ATEOs may take more time, but it is estimated that this determination will take less than seven hours. The burden for making this determination is estimated to fall on the small number of larger ATEOs. Putting these two groups together, the total estimated cost for all 261,118 ATEOs to make these determinations is \$1,255,760 per year, averaging \$4.81 per ATEO. Thus, the Treasury Department and the IRS have determined that the proposed rules regarding an ATEO's covered employees are unlikely to have a significant economic impact on affected small entities.

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public on both the number of entities affected (including whether specific industries are affected) and the economic impact of this proposed rule on small entities.

Pursuant to section 7805(f) of the Code, this proposed rule has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately \$164 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism, Congressional Review Act

Executive Order 13132 (titled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This proposed rule does not have federalism implications that are not required by the statute and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in this preamble under the “**ADDRESSES**” section. The Treasury Department and the IRS request comments on all aspects of these proposed

regulations. Any electronic comments submitted and, to the extent practicable, any paper comments submitted will be made available at <https://www.regulations.gov> or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of these regulations are William McNally of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes, Executive Compensation branch) and Patrick Sternal of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes, Exempt Organizations branch). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <https://www.irs.gov>.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements

Proposed Amendments to the Regulations

Accordingly, the Department of the Treasury and the Internal Revenue Service propose to amend 26 CFR parts 1 and 53 as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 ***

Par. 2. Section 1.338-1 is amended by revising paragraph (b)(2)(i) to read as follows:

§1.338-1 General principles; status of old target and new target.

* * * * *

(b) * * *

(2) * * *

(i) The rules applicable to employee benefit plans (including those plans described in sections 79, 104, 105, 106, 125, 127, 129, 132, 137, and 220), qualified pension, profit-sharing, stock bonus and annuity plans (sections 401(a) and 403(a)), simplified employee pensions (section 408(k)), tax qualified stock option plans (sections 422 and 423), welfare benefit funds (sections 419, 419A, 512(a)(3), and 4976), voluntary employee benefit associations (section 501(c)(9) and the regulations

thereunder), and tax on excess tax-exempt organization executive compensation (section 4960) and the regulations in part 53 under section 4960;

PART 53--FOUNDATION AND SIMILAR EXCISE TAXES

Par. 3. The authority citation for part 53 is revised to read in part as follows:

Authority: 26 U.S.C. 7805; 4960.

Par. 4. Sections 53.4960-0 through 53.4960-5 are added to read as follows:

Sec.

53.4960-0 Table of contents.

53.4960-1 Scope and definitions.

53.4960-2 Determination of remuneration paid for an applicable year.

53.4960-3 Determination of whether there is a parachute payment.

53.4960-4 Liability for tax on excess remuneration and excess parachute payments.

53.4960-5 Applicability date.

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§53.4960-4 Liability for tax on excess remuneration and excess parachute payments

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§53.4960-5 Applicability date

- (a) General applicability date.

§53.4960-1 Scope and definitions.

(a) Scope. This section provides definitions for purposes of section 4960, this section, and §§53.4960-2 through 53.4960-5. Section 53.4960-2 provides definitions and rules for determining the amount of remuneration paid for a taxable year. Section 53.4960-3 provides definitions and rules for determining whether a parachute payment is paid. Section 53.4960-4 provides definitions and rules for calculating the amount of excess remuneration paid for a taxable year, excess parachute payments paid in a taxable year, and liability for the excise tax. Section 53.4960-5 provides rules regarding the applicability date for the regulations under section 4960. The rules and definitions provided in this section through §53.4960-5 apply solely for purposes of section 4960 and this section through §53.4960-5 unless specified otherwise.

(b) Applicable tax-exempt organization--(1) In general. Applicable tax-exempt organization or ATEO means any organization that is the any of following types of organizations:

(i) Section 501(a) organization. The organization is exempt from taxation under section 501(a);

(ii) Section 521 farmers' cooperative. The organization is a farmers' cooperative organization described in section 521(b)(1);

(iii) Section 115(1) organization. The organization has income excluded from taxation under section 115(1); or

(iv) Section 527 political organization. The organization is a political organization described in section 527(e)(1).

(2) Certain foreign organizations. A foreign organization (as defined in §53.4948-1(a)) that, for its taxable year, receives substantially all of its support (other than gross investment income) from the date of its creation from sources outside of the United States is not an ATEO. See section 4948(b).

(c) Applicable year--(1) In general. Applicable year means the calendar year ending with or within the ATEO's taxable year. See §53.4960-4 regarding how an ATEO's applicable year affects the liability of related organizations.

(2) Examples. The following examples illustrate the rules of paragraph (c)(1) of this section.

(i) Example 1 (Calendar year taxpayer)--(A) Facts. ATEO 1 uses the calendar year as its taxable year and became an ATEO before 2021.

(B) Conclusion. ATEO 1's applicable year for its 2021 taxable year is the period from January 1, 2021, through December 31, 2021 (that is, the 2021 calendar year).

(ii) Example 2 (Fiscal year taxpayer)--(A) Facts. ATEO 2 uses a taxable year that starts July 1 and ends June 30 and became an ATEO before 2021.

(B) Conclusion. ATEO 2's applicable year for the taxable year beginning July 1, 2021, and ending June 30, 2022, is the 2021 calendar year.

(3) Short applicable years--(i) In general. An ATEO may have an applicable year that does not span the entire calendar year for the initial taxable year that the organization is an ATEO or for the taxable year in which the taxpayer ceases to be an ATEO. The beginning and end dates of the applicable year in the case of an ATEO's change in status depend on when the change in status occurs.

(ii) Initial year of ATEO status. For the taxable year in which an ATEO first becomes an ATEO, applicable year means the period beginning on the date the ATEO first becomes an ATEO and ending on the last day of the calendar year ending with or

within such taxable year (or, if earlier, the date of termination of ATEO status, as described in paragraph (c)(3)(ii)(A) of this section). If the taxable year in which an ATEO first becomes an ATEO ends before the end of the calendar year in which the ATEO first becomes an ATEO, then there is no applicable year for the ATEO's first taxable year; however, for the ATEO's next taxable year, applicable year means the period beginning on the date the ATEO first becomes an ATEO and ending on December 31 of the calendar year (or, if earlier, the date of termination of ATEO status, as described in paragraph (c)(3)(ii)(A) of this section).

(iii) Year of termination of ATEO status--(A) Termination on or before the close of the calendar year ending with or within the taxable year of termination. If an ATEO has a termination of ATEO status during the taxable year and the termination of ATEO status occurs on or before the close of the calendar year ending with or within such taxable year, then, for the taxable year of termination of ATEO status, applicable year means the period starting January 1 of the calendar year of the termination of ATEO status and ending on the date of the termination of ATEO status.

(B) Termination after the close of the calendar year ending in the taxable year of termination. If an ATEO has a termination of ATEO status during the taxable year and the termination of ATEO status occurs after the close of the calendar year ending within such taxable year, then, for the taxable year of the termination of ATEO status, applicable year means both the calendar year ending within such taxable year and the period beginning January 1 of the calendar year of the termination of ATEO status and ending on the date of the termination of ATEO status. Both such applicable years are treated as separate applicable years. See §53.4960-4(b)(2)(ii) for rules regarding

calculation of the tax in the event there are multiple applicable years associated with a taxable year.

(4) Examples. The following examples illustrate the rules of paragraph (c)(3) of this section. For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO and any entity referred to as “CORP” is not an ATEO.

(i) Example 1 (Taxable year of formation ending after December 31)--(A) Facts. ATEO 1, ATEO 2, and CORP 1 are related organizations that all use a taxable year that starts July 1 and ends June 30. ATEO 1 is recognized as a section 501(c)(3) organization by the IRS on May 8, 2022, effective as of October 1, 2021. ATEO 2 became an ATEO in 2017.

(B) Conclusion (ATEO 1). ATEO 1’s applicable year for the taxable year beginning October 1, 2021, and ending June 30, 2022, is the period beginning October 1, 2021, and ending December 31, 2021. For purposes of determining the amount of remuneration paid by ATEO 1 and all related organizations for ATEO 1’s taxable year beginning October 1, 2021, and ending June 30, 2022, (including for purposes of determining ATEO 1’s covered employees), only remuneration paid between October 1, 2021, and December 31, 2021, is taken into account. Thus, any remuneration paid by ATEO 1, ATEO 2, or CORP 1 before October 1, 2021, is disregarded for purposes of ATEO 1’s applicable year associated with its initial taxable year.

(C) Conclusion (ATEO 2). ATEO 2’s applicable year for its taxable year beginning July 1, 2021, and ending June 30, 2022, is the 2021 calendar year. Thus, any remuneration paid by ATEO 1, ATEO 2, or CORP 1 during the 2021 calendar year is taken into account for purposes of determining ATEO 2’s covered employees and remuneration paid for ATEO 2’s taxable year ending June 30, 2022.

(ii) Example 2 (Taxable year of formation ending before December 31)--(A) Facts. Assume the same facts as in paragraph (c)(4)(i)(A) of this section (Example 1), except that ATEO 1 is recognized as a section 501(c)(3) organization effective as of March 15, 2022.

(B) Conclusion. ATEO 1 has no applicable year for the taxable year starting March 15, 2022, and ending June 30, 2022, because no calendar year ends (or termination of ATEO status occurs) with or within the taxable year. ATEO 1’s applicable year for the taxable year ending June 30, 2023, is the period beginning March 15, 2022, and ending December 31, 2022. For purposes of determining the amount of remuneration paid by ATEO 1 and all related organizations for ATEO 1’s taxable year ending June 30, 2023 (including for purposes of determining ATEO 1’s covered employees), only remuneration paid between March 15, 2022, and December 31, 2022,

is taken into account. The conclusion for ATEO 2 is the same as in paragraph (c)(4)(i)(B) of this section (Example 1).

(iii) Example 3 (Termination before the close of the calendar year ending in the taxable year of termination)--(A) Facts. Assume the same facts as in paragraph (c)(4)(i)(A) of this section (Example 1). In addition, ATEO 1 has a termination of ATEO status on September 30, 2023.

(B) Conclusion. For ATEO 1's taxable year beginning July 1, 2023, and ending September 30, 2023, ATEO 1's applicable year is the period beginning January 1, 2023, and ending September 30, 2023.

(iv) Example 4 (Termination after the close of the calendar year ending in the taxable year of termination)--(A) Facts. Assume the same facts as in paragraph (c)(4)(i)(A) of this section (Example 1). In addition, ATEO 1 has a termination of ATEO status on March 31, 2024.

(B) Conclusion. For ATEO 1's taxable year beginning July 1, 2023, and ending March 31, 2024, ATEO 1 has two applicable years: the 2023 calendar year, and the period beginning on January 1, 2024, and ending on March 31, 2024.

(d) Covered employee--(1) In general. For each taxable year, covered employee means 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) for any preceding taxable year beginning after December 31, 2016.

(2) Five highest-compensated employees--(i) In general. Except as otherwise provided in this paragraph (d)(2), an individual is one of an ATEO's five highest-compensated employees for the taxable year if the individual is among the five employees of the ATEO with the highest amount of remuneration paid during the applicable year, as determined under §53.4960-2. However, remuneration described in §53.4960-2(f)(1), the deduction for which is disallowed by reason of section 162(m), is taken into account for purposes of determining an ATEO's five highest-compensated employees. The five highest-compensated employees of an ATEO for the taxable year are identified on the basis of the total remuneration paid during the applicable year to

the employee for services performed as an employee of the ATEO or any related organization. An ATEO may have fewer than five highest-compensated employees for a taxable year if it has fewer than five employees other than employees who are disregarded under paragraphs (d)(2)(ii) through (v) of this section. For purposes of this paragraph (d)(2), a grant of a legally binding right (within the meaning of §1.409A-1(b)) to vested remuneration is considered to be remuneration paid as of the date of grant, as described in §53.4960-2(c)(1), and a person or governmental entity is considered to grant a legally binding right to nonvested remuneration if the person or governmental entity grants a legally binding right to remuneration that is not vested within the meaning of §53.4960-2(c)(2). An employee is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if, during the applicable year, neither the ATEO nor any related organization paid remuneration or granted a legally binding right to nonvested remuneration to the individual for services the individual performed as an employee of the ATEO or any related organization.

(ii) Limited hours exception--(A) In general. An individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if, for the applicable year, all of the following requirements are met:

(1) Remuneration requirement. Neither the ATEO nor any related ATEO paid remuneration or granted a legally binding right to nonvested remuneration to the individual for services the individual performed as an employee of the ATEO; and

(2) Hours of service requirement. The individual performed services as an employee of the ATEO and all related ATEOs for no more than 10 percent of the total hours the individual worked as an employee of the ATEO and all related organizations.

For this purpose, an ATEO may instead use a percentage of total days worked by the employee, provided that any day that the employee works at least one hour for the ATEO is treated as a full day worked for the ATEO and not for any other organization.

(B) Certain payments disregarded. For purposes of paragraph (d)(2)(ii)(A)(1) of this section, a payment made to the individual during the ATEO's applicable year by a related organization that is an employer of the employee and for which the related organization is neither reimbursed by the ATEO nor entitled to any other consideration from the ATEO is not deemed paid by the ATEO under §53.4960-2(b)(1) and a payment made to the individual during the ATEO's applicable year by a related organization is not treated as paid by the ATEO under §53.4960-2(b)(2).

(C) Safe harbor. For purposes of paragraph (d)(2)(ii)(A)(2) of this section, an individual is treated as having performed services as an employee of the ATEO and all related ATEOs for no more than 10 percent of the total hours the individual worked as an employee of the ATEO and all related organizations during the applicable year if the employee performed no more than 100 hours of service for the ATEO and all related ATEOs during the applicable year.

(iii) Nonexempt funds exception--(A) In general. An individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if, for the applicable year, all of the following requirements are met:

(1) Remuneration requirement. Neither the ATEO, nor any related ATEO, nor any taxable related organization controlled by the ATEO (or by one or more related ATEOs, either alone or together with the ATEO) paid remuneration or granted a legally binding

right to nonvested remuneration to the individual for services the individual performed as an employee of an ATEO;

(2) Hours of service requirement. The individual performed services as an employee of the ATEO and all related ATEOs for less than 50 percent of the total hours worked as an employee of the ATEO and all related organizations. For this purpose, an ATEO may instead use a percentage of total days worked by the employee, provided that any day that the employee works at least one hour for the ATEO or a related ATEO is treated as a full day worked for the ATEO and not for any other organization; and

(3) Related organizations requirement. 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, either alone or together with the ATEO).

(B) Certain payments disregarded. For purposes of paragraph (d)(2)(iii)(A)(1) of this section, a payment made to the individual during the applicable year by a related organization that is an employer of the employee and for which the related organization is neither reimbursed by the ATEO nor entitled to any other consideration from the ATEO is not deemed paid by the ATEO under §53.4960-2(b)(1) and a payment made to the individual during the applicable year by a related organization is not treated as paid by the ATEO under §53.4960-2(b)(2).

(iv) Limited services exception. An employee is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year even

though the ATEO paid remuneration to the employee if, for the applicable year, disregarding §53.4960-2(b)(2), all of the following requirements are met:

(A) Remuneration requirement. The ATEO did not pay 10 percent or more of the employee's total remuneration for services performed as an employee of the ATEO and all related organizations; and

(B) Related organization requirement. The ATEO had at least one related ATEO and one of the following conditions apply:

(1) Ten percent remuneration condition. A related ATEO paid at least 10 percent of the remuneration paid by the ATEO and all related organizations; or

(2) Less remuneration condition. No related ATEO paid at least 10 percent of the total remuneration paid by the ATEO and all related organizations and the ATEO paid less remuneration to the employee than at least one related ATEO.

(3) Examples. The following examples illustrate the rules of this paragraph (d). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO, any entity referred to as "CORP" is not an ATEO and is not a publicly-held company within the meaning of section 162(m)(2) unless otherwise stated, and each entity has a calendar year taxable year.

(i) Example 1 (Employee of two related ATEOs)--(A) Facts. ATEO 1 and ATEO 2 are related organizations and have no other related organizations. Both employ Employee A during calendar year 2021 and pay remuneration to Employee A for Employee A's services. During 2021, Employee A performed services for 1,000 hours as an employee of ATEO 1 and 1,000 hours as an employee of ATEO 2.

(B) Conclusion. Employee A may be a covered employee of both ATEO 1 and ATEO 2 as one of the five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(i) of this section because the exceptions in paragraphs (d)(2)(ii) through (iv) of this section do not apply. Because they are related organizations, ATEO 1 and ATEO 2 must each include the remuneration paid to Employee A by the other

during each of their applicable years in determining their respective five highest-compensated employees for taxable year 2021.

(ii) Example 2 (Employee of an ATEO and a related non-ATEO)--(A) Facts. Assume the same facts as in paragraph (d)(3)(i) of this section (Example 1), except that ATEO 1 is instead CORP 1.

(B) Conclusion (CORP 1). For taxable year 2021, CORP 1 is not an ATEO and therefore does not need to identify covered employees.

(C) Conclusion (ATEO 2). Employee A may be a covered employee of ATEO 2 as one of its five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(i) of this section because no exception in paragraphs (d)(2)(ii) through (iv) of this section applies. ATEO 2 must include the remuneration paid to Employee A by CORP 1 during its applicable year in determining ATEO 2's five highest-compensated employees for taxable year 2021.

(iii) Example 3 (Amounts for which a deduction is disallowed under section 162(m) are taken into account for purposes of determining the five highest-compensated employees)--(A) Facts. CORP 2 is a publicly-held corporation within the meaning of section 162(m)(2) and is a related organization of ATEO 3. ATEO 3 is a corporation that is part of CORP 2's affiliated group (as defined in section 1504, without regard to section 1504(b)) and has no other related organizations. Employee B is a covered employee (as defined in section 162(m)(3)) of CORP 2 and an employee of ATEO 3. In 2021, CORP 2 paid Employee B \$8 million of remuneration for services provided as an employee of CORP 2 and ATEO 3 paid Employee B \$500,000 of remuneration for services provided as an employee of ATEO 3. \$7.5 million of the remuneration is compensation for which a deduction is disallowed pursuant to section 162(m)(1).

(B) Conclusion. The \$7.5 million of remuneration for which a deduction is disallowed under section 162(m)(1) is taken into account for purposes of determining ATEO 3's five highest-compensated employees. Thus, ATEO 3 is treated as paying Employee B \$8.5 million of remuneration for purposes of determining its five highest-compensated employees.

(iv) Example 4 (Employee disregarded due to receiving no remuneration)--(A) Facts. Employee C is an officer of ATEO 4. In 2021, neither ATEO 4 nor any related organization paid remuneration or granted a legally binding right to any nonvested remuneration to Employee C. ATEO 4 paid premiums for insurance for liability arising from Employee C's service with ATEO 4, which is properly treated as a working condition fringe benefit excluded from gross income under §1.132-5.

(B) Conclusion. Employee C is disregarded for purposes of determining ATEO 4's five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(i) of this section because neither ATEO 4 nor any related organization paid

Employee C any remuneration (nor did they grant a legally binding right to nonvested remuneration) in applicable year 2021. The working condition fringe benefit is not wages within the meaning of section 3401(a), as provided in section 3401(a)(19), and thus is not remuneration within the meaning of §53.4960-2(a).

(v) Example 5 (Limited hours exception)--(A) Facts. ATEO 5 and CORP 3 are related organizations. ATEO 5 has no other related organizations and does not control CORP 3. Employee D is an employee of CORP 3. As part of Employee D's duties at CORP 3, Employee D serves as an officer of ATEO 5. Only CORP 3 paid remuneration (or granted a legally binding right to nonvested remuneration) to Employee D and ATEO 5 did not reimburse CORP 3 for any portion of Employee D's remuneration in any manner. During 2021, Employee D provided services as an employee for 2,000 hours to CORP 3 and 200 hours to ATEO 5.

(B) Conclusion. Employee D is disregarded for purposes of determining ATEO 5's five highest-compensated employees for taxable year 2021. Employee D qualifies for the exception under paragraph (d)(2)(ii) of this section because only CORP 3 paid Employee D any remuneration or granted a legally binding right to nonvested remuneration in applicable year 2021 and Employee D provided services as an employee to ATEO 5 for 200 hours, which is not more than ten percent of the total hours ($2000 + 200 = 2200$) worked as an employee of ATEO 5 and all related organizations ($200 / 2200 = 9$ percent).

(vi) Example 6 (Limited hours exception)--(A) Facts. Assume the same facts as in paragraph (d)(3)(v) of this section (Example 5), except that ATEO 5 also provides a reasonable allowance for expenses incurred by Employee D in executing Employee D's duties as an officer of ATEO 5, which is properly excluded from gross income under an accountable plan described in §1.62-2.

(B) Conclusion. The conclusion is the same as in paragraph (d)(3)(v)(B) of this section (Example 5). Specifically, Employee D is disregarded for purposes of determining ATEO 5's five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(ii) of this section because the expense allowance under the accountable plan is excluded from wages within the meaning of section 3401(a), as provided in §31.3401(a)-4, and thus is not remuneration within the meaning of §53.4960-2(a).

(vii) Example 7 (No exception applies due to source of payment)--(A) Facts. Assume the same facts as in paragraph (d)(3)(v) of this section (Example 5), except that ATEO 5 has a contractual arrangement with CORP 3 to reimburse CORP 3 for the hours of service Employee D provides to ATEO 5 during applicable year 2021 by paying an amount equal to the total remuneration received by Employee D from both ATEO 5 and CORP 3 multiplied by a fraction equal to the hours of service Employee D provided ATEO 5 over Employee D's total hours of service to both ATEO 5 and CORP 3.

(B) Conclusion. Employee D may be one of ATEO 5's five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(i) of this section because the exceptions in paragraphs (d)(2)(ii) through (iv) of this section do not apply. Pursuant to the contractual arrangement between CORP 3 and ATEO 5, ATEO 5 reimburses CORP 3 for a portion of Employee D's remuneration during applicable year 2021; thus, the exceptions under paragraphs (d)(2)(ii) and (iii) of this section do not apply. Further, while ATEO 5 paid Employee D less than 10 percent of the total remuneration from ATEO 5 and all related organizations (200 hours of service to ATEO 5 / 2200 hours of service to ATEO 5 and all related organizations = 9.09 percent), it had no related ATEO; thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply.

(viii) Example 8 (Nonexempt funds exception)--(A) Facts. Assume the same facts as in paragraph (d)(3)(v) of this section (Example 5), except that during applicable year 2021, Employee D provided services as an employee for 1,000 hours to CORP 3 and 900 hours to ATEO 5 and CORP 3 provided no services to ATEO 5 for a fee.

(B) Conclusion. Employee D is disregarded for purposes of determining ATEO 5's five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(iii) of this section because Employee D works less than 50 percent of the year providing services for ATEO 5, and only CORP 3 paid any remuneration to Employee D during applicable year 2021.

(ix) Example 9 (Limited services exception)--(A) Facts. ATEO 6, ATEO 7, ATEO 8, and ATEO 9 are a group of related organizations, none of which have any other related organizations. During 2021, Employee E is an employee of ATEO 6, ATEO 7, ATEO 8, and ATEO 9. During applicable year 2021, ATEO 6 paid 5 percent of Employee E's remuneration, ATEO 7 paid 10 percent of Employee E's remuneration, ATEO 8 paid 25 percent of Employee E's remuneration, and ATEO 9 paid 60 percent of Employee E's remuneration. No exception under paragraph (d)(2)(ii) or (iii) applies to Employee E for any of ATEO 6, ATEO 7, ATEO 8, or ATEO 9.

(B) Conclusion (ATEO 6). Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2021 under paragraph (d)(2)(iv) of this section because ATEO 6 paid less than 10 percent of Employee E's total remuneration from ATEO 6 and all related organizations during applicable year 2021 and another related ATEO paid at least 10 percent of that total remuneration.

(C) Conclusion (ATEO 7, ATOE 8, and ATEO 9). Employee E may be one of the five highest-compensated employees of ATEO 7, ATEO 8, and ATEO 9 for taxable year 2021 because each of those ATEOs paid 10 percent or more of E's remuneration during the 2021 applicable year. Thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply.

(x) Example 10 (Limited services exception)--(A) Facts. Assume the same facts as in paragraph (d)(3)(ix) of this section (Example 9), except that for applicable year 2021, ATEO 6, ATEO 7, and ATEO 8 each paid 5 percent of Employee E's remuneration, ATEO 9 paid 6 percent of E's remuneration, and Employee E also works as an employee of CORP 4, a related organization of ATEO 6, ATEO 7, ATEO 8, and ATEO 9 that paid 79 percent of Employee E's remuneration for applicable year 2021.

(B) Conclusion (ATEO 9). Employee E may be one of ATEO 9's five highest compensated employees for taxable year 2021. Although ATEO 9 did not pay Employee E 10 percent or more of the total remuneration paid by ATEO 9 and all of its related organizations, no related ATEO paid more than 10 percent of Employee E's remuneration, and ATEO 9 did not pay less remuneration to employee E than at least one related ATEO. Thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply, and Employee E may be one of ATEO 9's five highest-compensated employees because ATEO 9 paid more remuneration than any other related ATEO.

(C) Conclusion (ATEO 6, ATEO 7, and ATEO 8). Employee E is disregarded for purposes of determining the five highest-compensated employees of ATEO 6, ATEO 7, and ATEO 8 for taxable year 2021 under paragraph (d)(2)(iv) of this section because none paid 10 percent or more of Employee F's total remuneration, each had no related ATEO that paid at least 10 percent of Employee E's total remuneration, and each paid less remuneration than at least one related ATEO (ATEO 9).

(e) Employee--(1) In general. Employee means an employee as defined in section 3401(c) and §31.3401(c)-1. Section 31.3401(c)-1 generally defines an employee 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. As set forth in §31.3401(c)-1, this includes common law employees, as well as officers and employees of government entities, whether or not elected. An employee generally also includes an officer of a corporation, but an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration is not considered to be an employee of the corporation solely due to the individual's status as an officer of

the corporation. Whether an individual is an employee depends on the facts and circumstances.

(2) Directors. A director of a corporation (or an individual holding a substantially similar position in a corporation or other entity) in the individual's capacity as such is not an employee of the corporation. See §31.3401(c)-1(f).

(3) Trustees. The principles of paragraph (e)(2) of this section apply by analogy to a trustee of any arrangement classified as a trust for Federal tax purposes in §301.7701-4(a).

(f) Employer--(1) In general. Employer means an employer within the meaning of section 3401(d), without regard to section 3401(d)(1) or (2), meaning generally the person or governmental entity for whom the services were performed as an employee. Whether a person or governmental entity is the employer depends on the facts and circumstances, but a person does not cease to be the employer through use of a payroll agent under section 3504, a common paymaster under section 3121(s), a person described in section 3401(d)(1) or (2), a certified professional employer organization under section 7705, or any similar arrangement.

(2) Disregarded entities. In the case of a disregarded entity described in §301.7701-3, §301.7701-2(c)(2)(iv) does not apply; thus, the sole owner of the disregarded entity is treated as the employer of any individual performing services as an employee of the disregarded entity.

(g) Medical services--(1) Medical and veterinary services--(i) In general. Medical services means services directly performed by a licensed medical professional (as defined in paragraph (g)(2) of this section) for the diagnosis, cure, mitigation, treatment,

or prevention of disease in humans or animals; services provided for the purpose of affecting any structure or function of the human or animal body; and other services integral to providing such medical services. For purposes of section 4960, teaching and research services are not medical services except to the extent that they involve the services performed to directly diagnose, cure, mitigate, treat, or prevent disease or affect a structure or function of the body. Administrative services may be integral to directly providing medical services. For example, documenting the care and condition of a patient is integral to providing medical services, as is accompanying another licensed professional as a supervisor while that medical professional provides medical services. However, managing an organization's operations, including scheduling, staffing, appraising employee performance, and other similar functions that may relate to a particular medical professional or professionals who perform medical services, is not integral to providing medical services. See §53.4960-2-(a)(2)(ii) for rules regarding allocating remuneration paid to a medical professional who performs both medical services and other services.

(ii) Examples. The following examples illustrate the rules of this paragraph (g):

(A) Example 1 (Administrative tasks that are integral to providing medical services)--(1) Facts. Employee A is a doctor who is licensed to practice medicine in the state in which Employee A's place of employment is located. In the course of Employee A's practice, Employee A treats patients and performs some closely-related administrative tasks, such as examining and updating patient records.

(2) Conclusion. Employee A's administrative tasks are integral to providing medical services and thus are medical services.

(B) Example 2 (Administrative tasks that are not integral to providing medical services)--(1) Facts. Assume the same facts as in paragraph (g)(1)(ii)(A)(1) of this section (Example 1), except that Employee A also performs additional administrative tasks such as analyzing the budget, authorizing capital expenditures, and managing human resources for the organization by which Employee A is employed.

(2) Conclusion. Employee A's additional administrative tasks are not integral to providing medical services and thus are not medical services.

(C) Example 3 (Teaching duties that are and are not medical services)--(1) Facts. Employee B is a medical doctor who is licensed to practice medicine in the state in which her place of employment, a university hospital, is located. Employee B's duties include overseeing and teaching a group of resident physicians who have restricted licenses to practice medicine. Those duties include supervising and instructing the resident physicians while they treat patients and instruction in a classroom setting.

(2) Conclusion. Employee B's supervision and instruction of resident physicians during the course of patient treatment are necessary for the treatment, and thus are medical services. Employee B's classroom instruction is not necessary for patient treatment, and thus is not medical services.

(D) Example 4 (Research services that are and are not medical services)--(1) Facts. Employee C is a licensed medical doctor who is employed to work on a research trial. Employee C provides an experimental treatment to patients afflicted by a disease and performs certain closely-related administrative tasks that ordinarily are performed by a medical professional in a course of patient treatment. As part of the research trial, Employee C also compiles and analyzes patient results and prepares reports and articles that would not ordinarily be prepared by a medical professional in the course of patient treatment.

(2) Conclusion. Employee C's services that are ordinarily performed by a medical professional in a course of treatment, including closely-related administrative tasks, are medical services. Because the compilation and analysis of patient results and the formulation of reports and articles are neither services ordinarily performed by a medical professional in a course of treatment nor necessary for such treatment, these services are not medical services.

(2) Definition of licensed medical professional. Licensed medical professional means an individual who is licensed under applicable state or local law to perform medical services, including as a doctor, nurse, nurse practitioner, dentist, veterinarian, or other licensed medical professional.

(h) Predecessor--(1) Asset acquisitions. If an ATEO (acquiror) acquires at least 80 percent of the operating assets or total assets (determined by fair market value on the date of acquisition) of another ATEO (target), then the target is a predecessor of the

acquiror. For an acquisition of assets that occurs over time, only assets acquired within a 12-month period are taken into account to determine whether at least 80 percent of the target's operating assets or total assets were acquired. However, this 12-month period is extended to include any continuous period that ends or begins on any day during which the acquiror has an arrangement to purchase, directly or indirectly, assets of the target. Additions to the assets of target made as part of a plan or arrangement to avoid the application of this subsection to acquiror's purchase of target's assets are disregarded in applying this paragraph. This paragraph (h)(1) applies for purposes of determining whether an employee is a covered employee under paragraph (d)(1) of this section only with respect to a covered employee of the target who commences the performance of services for the acquiror (or a related organization with respect to the acquiror) within the period beginning 12 months before and ending 12 months after the date of the transaction as defined in paragraph (h)(7) of this section.

(2) Corporate reorganizations. A predecessor of an ATEO includes another separate ATEO the stock or assets of which are acquired in a corporate reorganization as defined in section 368(a)(1)(A), (C), (D), (E), (F), or (G) (including by reason of section 368(a)(2)).

(3) Predecessor change of form or of place of organization. An ATEO that restructured by changing its organizational form or place of organization (or both) is a predecessor of the restructured ATEO.

(4) ATEO that becomes a non-ATEO--(i) General rule. An organization is a predecessor of an ATEO if it ceases to be an ATEO and then again becomes an ATEO effective on or before the predecessor end date. The predecessor end date is the date

that is 36 months following the date that the organization's Federal information return under section 6033 (or, for an ATEO described in paragraph (b)(1)(ii) or (iii) of this section, its Federal income tax return under section 6011(a)) is due (or would be due if the organization were required to file), excluding any extension, for the last taxable year for which the organization previously was an ATEO. If the organization becomes an ATEO again effective after the predecessor end date, then the former ATEO is treated as a separate organization that is not a predecessor of the current ATEO.

(ii) Intervening changes or entities. If an ATEO that ceases to be an ATEO (former ATEO) would be treated as a predecessor to an organization that becomes an ATEO before the predecessor end date (successor ATEO), and if the former ATEO would be treated as a predecessor to each intervening entity (if such intervening entities had been ATEOs) under the rules of this paragraph (h), then the former ATEO is a predecessor of the successor ATEO. For example, if ATEO 1 loses its tax-exempt status and then merges into Corporation X, Corporation X then merges into Corporation Y, and Corporation Y becomes an ATEO before the predecessor end date, then ATEO 1 is a predecessor of Corporation Y.

(5) Predecessor of a predecessor. A reference to a predecessor includes any predecessor or predecessors of such predecessor, as determined under these rules.

(6) Elections under sections 336(e) and 338. For purposes of this paragraph (h), when an ATEO organized as a corporation makes an election to treat as an asset purchase either the sale, exchange, or distribution of stock pursuant to regulations under section 336(e) or the purchase of stock pursuant to regulations under section

338, the corporation that issued the stock is treated as the same corporation both before and after such transaction.

(7) Date of transaction. For purposes of this paragraph (h), the date that a transaction is treated as having occurred is the date on which all events necessary to complete the transaction described in the relevant provision have occurred.

(i) Related organization--(1) In general. Related organization means any person or governmental entity, domestic or foreign, that meets any of the following tests:

(i) Controls or controlled by test. The person or governmental entity controls, or is controlled by, the ATEO;

(ii) Controlled by same persons test. The person or governmental entity is controlled by one or more persons that control the ATEO;

(iii) Supported organization test. The person or governmental entity is a supported organization (as defined in section 509(f)(3)) with respect to the ATEO;

(iv) Supporting organization test. The person or governmental entity is a supporting organization described in section 509(a)(3) with respect to the ATEO; or

(v) VEBA test. With regard to an ATEO that is a voluntary employees' beneficiary association described in section 501(c)(9), the person or governmental entity establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.

(2) Control--(i) In general. Control may be direct or indirect. For rules concerning application of the principles of section 318 in applying this paragraph (i)(2), see paragraph (i)(2)(vii) of this section.

(ii) Stock corporation. A person or governmental entity controls a stock corporation if it owns (by vote or value) more than 50 percent of the stock in the stock corporation.

(iii) Partnership. A person or governmental entity controls a partnership if it owns more than 50 percent of the profits interests or capital interests in the partnership.

(iv) Trust. A person or governmental entity controls a trust if it owns more than 50 percent of the beneficial interests in the trust, determined by actuarial value.

(v) Nonstock organization--(A) In general. A person or governmental entity controls a nonstock organization if more than 50 percent of the trustees or directors of the nonstock organization are either representatives of, or directly or indirectly controlled by, the person or governmental entity. A nonstock organization is a nonprofit organization or other organization without owners and includes a governmental entity.

(B) Control of a trustee or director of a nonstock organization. A person or governmental entity controls a trustee or director of the nonstock organization if the person or governmental entity has the power (either at will or at regular intervals) to remove such trustee or director and designate a new one.

(C) Representatives. Trustees, directors, officers, employees, or agents of a person or governmental entity are deemed representatives of the person or governmental entity. However, an employee of a person or governmental entity (other than a trustee, director, or officer, or an employee who possesses at least the authority commonly exercised by an officer) who is a director or trustee of a nonstock organization (or acting in that capacity) will not be treated as a representative of the person or governmental entity if the employee does not act as a representative of the

person or governmental entity and that fact is reported in the form and manner prescribed by the Commissioner in forms and instructions.

(vi) Brother-sister related organizations. Under paragraph (i)(1)(ii) of this section, an organization is a related organization with respect to an ATEO if one or more persons control both the ATEO and the other organization. In the case of control by multiple persons, the control tests described in this paragraph (i)(2) of this section apply to the persons as a group. For example, if 1,000 individuals who are members of both ATEO 1 and ATEO 2 elect a majority of the board members of each organization, then ATEO 1 and ATEO 2 are related to each other because the same group of 1,000 persons controls both ATEO 1 and ATEO 2.

(vii) Section 318 principles--(A) In general. Section 318 (relating to constructive ownership of stock) applies in determining ownership of stock in a corporation. The principles of section 318 also apply for purposes of determining ownership of interests in a partnership or in a trust with beneficial interests. For example, applying the principles of section 318(a)(1)(A), an individual is considered to own the partnership interest or trust interest owned, directly or indirectly, by or for the family members specified in such section.

(B) Nonstock organizations--(1) Attribution of ownership interest from a nonstock organization to a controlling person. If a person or governmental entity controls a nonstock organization, the person or governmental entity is treated as owning a percentage of the stock (or partnership interest or beneficial interest in a trust) owned by the nonstock organization in accordance with the percentage of trustees or directors of

the nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity.

(2) Attribution of ownership interest from a controlling person to a nonstock organization. If a person or governmental entity controls a nonstock organization, the nonstock organization is treated as owning a percentage of the stock (or partnership interest or beneficial interest in a trust) owned by the person or governmental entity in accordance with the percentage of trustees or directors of the nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity.

(3) Indirect control of a nonstock organization through another nonstock organization. If a person or governmental entity controls one nonstock organization that controls a second nonstock organization, the person or governmental entity is treated as controlling the second nonstock organization if the product of the percentage of trustees or directors of the first nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity, multiplied by the percentage of trustees or directors of the second nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity or first nonstock organization, exceeds 50 percent. Similar principles apply to successive tiers of nonstock organizations.

(4) Attribution of control of nonstock organization to family member. An individual's control of a nonstock organization or of a trustee or director of a nonstock organization is attributed to the members of the individual's family (as set forth in

section 318(a)(1) and the regulations thereunder), subject to the limitation of section 318(a)(5)(B) and the regulations thereunder.

(3) Examples. The following examples illustrate the principles of this paragraph

(i). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO and any entity referred to as “CORP” is not an ATEO.

(i) Example 1 (Related through a chain of control)--(A) Facts. ATEO 1, ATEO 2, and ATEO 3 are nonstock organizations. ATEO 3 owns 80 percent of the stock (by value) of corporation CORP 1. Eighty percent of ATEO 2’s directors are representatives of ATEO 1. In addition, 80 percent of ATEO 3’s directors are representatives of ATEO 1.

(B) Conclusion. ATEO 1 is a related organization with respect to ATEO 2 (and vice versa) because more than 50 percent of ATEO 2’s directors are representatives of ATEO 1; thus, ATEO 1 controls ATEO 2. Based on the same analysis, ATEO 1 is also a related organization with respect to ATEO 3 (and vice versa). CORP 1 is a related organization with respect to ATEO 3 because, as the owner of more than 50 percent of CORP 1’s stock, ATEO 3 controls CORP 1. Applying the principles of section 318, ATEO 1 is deemed to own 64 percent of the stock of CORP 1 (80 percent of ATEO 3’s stock in CORP 1). Thus, CORP 1 is a related organization with respect to ATEO 1 because ATEO 1 controls CORP 1. ATEO 2 is a related organization with respect to ATEO 3, ATEO 3 is a related organization with respect to ATEO 2, and CORP 1 is a related organization with respect to ATEO 2 because ATEO 2, ATEO 3, and CORP 1 are all controlled by the same person (ATEO 1).

(ii) Example 2 (Not related through a chain of control)--(A) Facts. ATEO 4, ATEO 5, and ATEO 6 are nonstock organizations. Sixty percent of ATEO 5’s directors are representatives of ATEO 4. In addition, 60 percent of ATEO 6’s directors are representatives of ATEO 5, but none are representatives of ATEO 4.

(B) Conclusion. ATEO 4 is a related organization with respect to ATEO 5 (and vice versa) because more than 50 percent of ATEO 5’s directors are representatives of ATEO 4; thus, ATEO 4 controls ATEO 5. Based on the same analysis, ATEO 6 is a related organization with respect to ATEO 5 (and vice versa). Applying the principles of section 318, ATEO 4 is deemed to control 36 percent of ATEO 6’s directors (60 percent of ATEO 5’s 60 percent control over ATEO 6). Because less than 50 percent of ATEO 6’s directors are representatives of ATEO 4, and absent any facts suggesting that ATEO 4 directly or indirectly controls ATEO 6, ATEO 4 and ATEO 6 are not related organizations with respect to each other.

§53.4960-2 Determination of remuneration paid for a taxable year.

(a) Remuneration--(1) In general. For purposes of section 4960, remuneration means any amount that is wages as defined in section 3401(a), excluding any designated Roth contribution (as defined in section 402A(c)) and including any amount required to be included in gross income under section 457(f). Remuneration includes amounts includible in gross income as compensation for services as an employee pursuant to a below-market loan described in section 7872(c)(1)(B)(i) (compensation-related loans). For example, see §1.7872-15(e)(1)(i). Director's fees paid by a corporation to a director of the corporation are not remuneration, provided that if the director is also an employee of the corporation, the director's fees are excluded from remuneration only to the extent that they do not exceed fees paid to a director who is not an employee of the corporation or any related organization or, if there is no such director, they do not exceed reasonable director's fees.

(2) Exclusion of remuneration for medical services--(i) In general. Remuneration does not include the portion of any remuneration paid to a licensed medical professional that is for the performance of medical services by such professional.

(ii) Allocation of remuneration for medical services and non-medical services. If, during an applicable year, an employer pays a covered employee remuneration for providing both medical services and non-medical services, the employer must make a reasonable, good faith allocation between the remuneration for medical services and the remuneration for non-medical services. For example, if a medical doctor receives remuneration for providing medical services and administrative or management services, the employer must make a reasonable, good faith allocation between the

remuneration for the medical services and the 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 applies unless the facts and circumstances demonstrate that the amount allocated to 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 agreement or similar arrangement, 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 employee worked for the employer (and any related 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 agreement or other similar arrangement, an employer may use salaries or other remuneration paid by the employer or similarly situated employers for duties comparable to those the employee performs (for example, hospital administrator and physician) for purposes of making a reasonable allocation between remuneration for providing medical services and for providing non-medical services.

(iii) Examples. The following examples illustrate the rules of this paragraph (a)(2). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO.

(A) Example 1 (Allocation based on employment agreement)--(1) Facts. Employee A is a covered employee of ATEO 1. Employee A is a licensed medical

professional who provides patient care services for ATEO 1 and also provides management and administrative services to ATEO 1 as the manager of a medical practice group within ATEO 1. The employment agreement between ATEO 1 and Employee A specifies that of Employee A's salary, 30 percent is allocable to Employee A's services as manager of the medical practice group and 70 percent is allocable to Employee A's services as a medical professional providing patient care services. The facts regarding Employee A's employment indicate the employment agreement provides a reasonable allocation and that the allocation was not established for purposes of avoiding application of the excise tax.

(2) Conclusion. Consistent with Employee A's employment agreement, ATEO 1 must allocate 30 percent of Employee A's salary to the provision of non-medical services and 70 percent of Employee A's salary to the provision of medical services. Accordingly, only the 30 percent portion of Employee A's salary allocated to the other, non-medical services is remuneration for purposes of paragraph (a) of this section.

(B) Example 2 (Allocation based on billing records)--(1) Facts. Assume the same facts as in paragraph (a)(2)(iii)(A) of this section (Example 1), except that the employment agreement does not allocate Employee A's salary between medical and non-medical services performed by Employee A. Based on a representative sample of insurance and Medicare billing records, as well as time reports that Employee A submits to ATEO 1, ATEO 1 determines that Employee A spends 50 percent of her work hours providing patient care and 50 percent of her work hours performing administrative and management services. ATEO 1 allocates 50 percent of Employee A's remuneration to medical services.

(2) Conclusion. ATEO 1's allocation of Employee A's salary is a reasonable, good faith allocation. Accordingly, only the 50 percent portion of Employee A's remuneration allocated to the non-medical services is remuneration for purposes of paragraph (a) of this section.

(b) Source of payment--(1) Remuneration paid by a third party for employment by an employer. Remuneration paid (or a grant of a legally binding right to nonvested remuneration) by a third-party payor (whether a related organization, payroll agent, or other entity) during an applicable year for services performed as an employee of an employer is deemed paid (or payable) by the employer, except as otherwise provided in §53.4960-1(d)(2)(ii) and (iii).

(2) Remuneration paid by a related organization for employment by the related organization. Remuneration paid (or a grant of a legally binding right to nonvested

remuneration) by a related organization to an ATEO's employee during an applicable year for services performed as an employee of the related organization is treated as paid (or payable) by the ATEO, except as otherwise provided in §53.4960-1(d)(2)(ii) and (iii).

(c) Applicable year in which remuneration is treated as paid--(1) In general.

Remuneration that is a regular wage within the meaning of §31.3402(g)-1(a)(1)(ii) is treated as paid on the date it is actually or constructively paid and all other remuneration is treated as paid on the first date on which the remuneration is vested.

(2) Vested remuneration. Remuneration is vested if it 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 remuneration is to be paid is deferred compensation described in section 457(f) or 409A). In general, an amount is subject to a substantial risk of forfeiture 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. Except as provided in paragraph (c)(1) of this section, remuneration that is never subject to a substantial risk of forfeiture is considered paid on the first date the service provider has a legally binding right to the payment. For purposes of this section, a plan means a plan within the meaning of §1.409A-1(c), an account balance plan means an account balance plan within the meaning of §1.409A-1(c)(2)(i)(A), and a nonaccount balance plan means a nonaccount balance plan within the meaning of §1.409A-1(c)(2)(i)(C). Net earnings on previously paid remuneration (described in paragraph (d)(2) of this section) that are not subject to a substantial risk of forfeiture are vested (and, thus, treated as

paid) at the earlier of the date actually or constructively paid to the employee or the close of the applicable year in which they accrue. For example, the present value of a principal amount accrued to an employee's account under an account balance plan (under which the earnings and losses attributed to the account are based solely on a predetermined actual investment as determined under §31.3121(v)(2)-1(d)(2)(i)(B) or a reasonable market interest rate) is treated as paid on the date vested, but the present value of any net earnings subsequently 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 applicable year in which they accrue. Similarly, while the present value of an amount accrued under a nonaccount balance (including earnings that accrued while the amount was nonvested) is treated as paid on the date it is first vested, 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 applicable year in which they accrue.

(3) Change in related status during the year. If a taxpayer becomes or ceases to be a related organization with respect to an ATEO during an applicable year, then only the remuneration paid by the taxpayer to an employee with respect to services performed as an employee of the related organization during the portion of the applicable year during which the employer is a related organization is treated as paid by the ATEO. If an amount is treated as paid due to vesting in the year the taxpayer becomes or ceases to be a related organization with respect to the ATEO, then the amount is treated as paid by the ATEO only if the amount becomes vested during the

portion of the applicable year that the taxpayer is a related organization with respect to the ATEO.

(d) Amount of remuneration treated as paid--(1) In general. For each applicable year, the amount of remuneration treated as paid by the employer to a covered employee is the sum of regular wages within the meaning of §31.3402(g)-1(a)(1)(ii) actually or constructively paid during the applicable year and the present value (as determined under paragraph (e) of this section) of all other remuneration that vested during the applicable year. The amount of remuneration that vests during an applicable year is determined on an employer-by-employer basis with respect to each covered employee.

(2) Earnings and losses on previously paid remuneration--(i) In general. The amount of net earnings or losses on previously paid remuneration paid by an employer is determined on an employee-by-employee basis, such that amounts accrued with regard to one employee do not affect amounts accrued with regard to a different employee. Similarly, losses accrued on previously paid remuneration from one employer do not offset earnings accrued on previously paid remuneration from another employer. The amount of net earnings or losses on previously paid remuneration paid by the employer is determined on a net aggregate basis for all plans maintained by the employer in which the employee participates for each applicable year. For example, losses under an account balance plan may offset earnings under a nonaccount balance plan for the same applicable year maintained by the same employer for the same employee.

(ii) Previously paid remuneration--(A) New covered employee. For an individual who was not a covered employee for any prior applicable year, previously paid remuneration means, for the applicable year for which the individual becomes a covered employee, the present value of vested remuneration that was not actually or constructively paid or otherwise includible in the employee's gross income before the start of the applicable year plus any remuneration that vested during the applicable year but that is not actually or constructively paid or otherwise includible in the employee's gross income before the close of the applicable year.

(B) Existing covered employee. For an individual who was a covered employee for any prior applicable year, previously paid remuneration means, for each applicable year, the amount of remuneration that the employer treated as paid in the applicable year or for a prior applicable year but that is not actually or constructively paid or otherwise includible in the employee's gross income before the close of the applicable year. Actual or constructive payment or another event causing an amount of previously paid remuneration to be includible in the employee's gross income thus reduces the amount of previously paid remuneration.

(iii) Earnings. Earnings means any increase in the vested present value of previously paid remuneration as of the close of the applicable year, regardless of whether the plan denominates the increase as earnings. 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 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 (and therefore may not be offset with losses). Likewise, an increase in the benefit under a nonaccount balance plan due to an additional year of service or an increase in compensation that is reflected in a benefit formula does not constitute earnings.

(iv) Losses. Losses means any decrease in the vested present value of previously paid remuneration as of the close of the applicable year, regardless of whether the plan denominates that decrease as losses.

(v) Net earnings. Net earnings means, for each applicable year, the amount (if any) by which the earnings accrued for the applicable year on previously paid remuneration exceeds the sum of the losses accrued on previously paid remuneration for the applicable year and any net losses carried forward from a previous taxable year.

(vi) Net losses. Net losses means, for each applicable year, the amount (if any) by which the sum of the losses accrued on previously paid remuneration for the applicable year and any net losses carried forward from a previous taxable year exceed the earnings accrued for the applicable year on previously paid remuneration. Losses may only be used to offset earnings and thus do not reduce the remuneration treated as paid for an applicable year except to the extent of the earnings accrued for that applicable year. However, with regard to a covered employee, an employer may carry net losses forward to the next applicable year and offset vested earnings for purposes of determining net earnings or losses for that subsequent applicable year. For example,

if a covered employee who participates in a nonaccount balance plan and an account balance plan vests in an amount of earnings under the nonaccount balance plan and has losses under the account balance plan that exceed the vested earnings treated as remuneration under the nonaccount balance plan, those excess losses are carried forward to the next applicable year and offset vested earnings for purposes of determining net earnings or losses for that applicable year. If, for the next applicable 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 subsequent applicable year until there are sufficient earnings for the applicable year to offset any remaining losses carried forward.

(3) Remuneration paid for a taxable year before the employee becomes a covered employee--(i) In general. In accordance with the payment timing rules of paragraph (c) of this section, any remuneration that is vested but is not actually or constructively paid or otherwise includible in an employee's gross income as of the close of the applicable year for the taxable year immediately preceding the taxable year in which the employee first becomes a covered employee of an ATEO is treated as previously paid remuneration for the taxable year in which the employee first becomes a covered employee. Net losses on this previously paid remuneration from any preceding applicable year do not carry forward to subsequent applicable years. However, net earnings and losses that vest on such previously paid remuneration in subsequent applicable years are treated as remuneration paid for a taxable year for which the employee is a covered employee.

(ii) Examples. The following examples illustrate the rules of this paragraph (d)(3).

For purposes of these examples, assume any organization described as “ATEO” is an ATEO.

(A) Example 1 (Earnings on pre-covered employee remuneration)--(1) Facts. ATEO 1 uses a taxable year beginning July 1 and ending June 30. Employee A becomes a covered employee of ATEO 1 for the taxable year beginning July 1, 2021, and ending June 30, 2022. During the 2020 applicable year, Employee A vests in \$1 million of nonqualified deferred compensation. As of December 31, 2020, the present value of the amount deferred under the plan is \$1.1 million. During the 2021 applicable year, ATEO 1 pays Employee A \$1 million in regular wages. The present value as of December 31, 2021, of Employee A’s nonqualified deferred compensation is \$1.3 million.

(2) Conclusion (Taxable year beginning July 1, 2020, and ending June 30, 2021). ATEO 1 pays Employee A \$1.1 million of remuneration in the 2020 applicable year. This is comprised of \$1 million of vested nonqualified deferred compensation, and \$100,000 of earnings, all of which is treated as paid for the taxable year beginning July 1, 2020, and ending June 30, 2021.

(3) Conclusion (Taxable year beginning July 1, 2021, and ending June 30, 2022). ATEO 1 pays Employee A \$1.2 million of remuneration in the 2021 applicable year. This is comprised of \$1 million regular wages and \$200,000 of earnings (\$1.3 million present value as of December 31, 2021, minus \$1.1 million previously paid remuneration as of December 31, 2020).

(B) Example 2 (Losses on pre-covered employee remuneration)--(1) Facts. Assume the same facts as in paragraph (d)(3)(ii)(A) of this section (Example 1), except that the present value of the nonqualified deferred compensation as of December 31, 2020, is \$900,000.

(2) Conclusion (Taxable year beginning July 1, 2020, and ending June 30, 2021). ATEO 1 pays Employee A \$1 million of remuneration in the 2020 applicable year. This is comprised of \$1 million of vested nonqualified deferred compensation. The present value of all vested deferred compensation as of December 31 of the 2020 applicable year (\$900,000) is treated as previously paid remuneration for the next applicable year (as Employee A is a covered employee for the next taxable year). The \$100,000 of losses accrued while Employee A was not a covered employee do not carry forward to the next applicable year.

(3) Conclusion (Taxable year beginning July 1, 2021, and ending June 30, 2022). ATEO 1 pays Employee A \$1.4 million of remuneration in the 2021 applicable year. This is comprised of \$1 million cash and \$400,000 of earnings (\$1.3 million present value as of December 31, 2021, minus \$900,000 previously paid remuneration).

(e) Calculation of present value--(1) In general. The employer must determine present value using reasonable actuarial assumptions regarding the amount, time, and probability that a payment will be made. For this purpose, a discount for the probability that an employee will die before commencement of benefit payments is permitted, but only to the extent that benefits will be forfeited upon death. The present value may not be discounted for the probability that payments will not be made (or will be reduced) because of the unfunded status of the plan; the risk associated with any deemed or actual investment of amounts deferred under the plan; the risk that the employer, the trustee, or another party will be unwilling or unable to pay; the possibility of future plan amendments; the possibility of a future change in the law; or similar risks or contingencies. 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 that are not previously paid remuneration.

(2) Treatment of future payment amount as present value for certain amounts. For purposes of determining the present value of remuneration under a nonaccount balance that is scheduled to be actually or constructively paid within 90 days of vesting, the employer may treat the future amount that is to be paid as the present value at vesting.

(f) Coordination with section 162(m)--(1) 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 this section. 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 this section. However, any amount of remuneration for which a deduction is disallowed by reason of section 162(m) is not taken into account for purposes of determining the amount of remuneration paid for a taxable year. Thus, if an amount of remuneration would be treated as paid under this section and a deduction for that amount is otherwise available but disallowed under section 162(m), that remuneration is not taken into account for purposes of determining the amount of remuneration paid for the taxable year under this section.

(2) Five highest-compensated employees. Solely for purposes of determining an ATEO's five highest-compensated employees under §53.4960-1(d)(2), remuneration for which a deduction is disallowed by reason of section 162(m) is treated as paid by the ATEO in the applicable year in which the remuneration would otherwise be treated as paid under paragraph (c)(1) of this section.

(3) Example. The following example illustrates the rules of this paragraph (f). For purposes of this example, assume any entity referred to as "ATEO" is an ATEO, any entity referred to as "CORP" is not an ATEO, and that all entities use a calendar year taxable year.

(i) Example (Remuneration disregarded because a deduction is disallowed under section 162(m) in the year of vesting)--(A) Facts. CORP 1 is a publicly held corporation described in section 162(m)(2) that is not a health insurance issuer described in section 162(m)(6)(C). CORP 1 and ATEO 1 are related organizations and ATEO 1 is not a member of CORP 1's affiliated group (as defined in section 1504 (determined without regard to section 1504(b))). Employee A is a covered employee described in section 162(m)(3) of CORP 1 and a covered employee of ATEO 1. In 2021, CORP 1 pays Employee A \$1.5 million as salary and ATEO 1 pays Employee A \$500,000 as salary. But for application of section 162(m), the amount paid is otherwise deductible by CORP 1. The amount of remuneration subject to the deduction limitation under section 162(m)(1) is \$500,000, the amount by which the compensation paid by CORP 1 exceeds the \$1 million deduction limitation described in section 162(m)(1).

(B) Conclusion. The \$500,000 not deductible under section 162(m) is not taken into account for purposes of determining the amount of remuneration paid by ATEO 1. Thus, ATEO 1 is generally treated as paying \$1.5 million of remuneration to Employee A for the 2021 taxable year (\$1 million salary from CORP 1 + \$500,000 salary from ATEO 1). However, for purposes of determining ATEO 1's five highest-compensated employees for the 2021 applicable year, ATEO 1 is treated as paying \$2 million of remuneration to Employee A (\$1 million salary from CORP 1 that is deductible under section 162(m) + \$500,000 salary from CORP 1 that is not deductible under section 162(m) + \$500,000 salary from ATEO 1).

(g) Examples. The following examples illustrate the rules of this section. For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO, any entity referred to as "CORP" is not an ATEO, and all entities use a calendar year taxable year.

(1) Example 1 (Account balance plan)--(i) Facts. Employee A is a covered employee of ATEO 1. Employee A participates in a nonqualified deferred compensation plan (the NQDC plan) in which the account balance is adjusted based on the investment returns on predetermined actual investments. On January 1, 2021, ATEO 1 credits \$100,000 to Employee A's account under the plan, subject to the requirement that Employee A remain employed through June 30, 2023. On June 30, 2023, 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: \$115,000 on December 31, 2023, \$120,000 on December 31, 2024, \$100,000 on December 31, 2025, and \$110,000 on December 31, 2026. During 2027, Employee A defers an additional \$10,000 under the plan, all of which is vested at the time of deferral. On December 31, 2027, the closing account balance is \$125,000. In 2028, ATEO 1 distributes \$10,000 to Employee A under the plan. On December 31, 2028, the closing account balance is \$135,000 due to earnings on the account balance.

(ii) Conclusion (2021 and 2022 applicable years - nonvested amounts). For 2021 and 2022, ATEO 1 pays Employee A no remuneration attributable to Employee A's participation in the NQDC plan because the amount deferred under the plan remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B).

(iii) Conclusion (2023 applicable year - amounts in year of vesting). For 2023, ATEO 1 pays Employee A \$115,000 of remuneration attributable to Employee A's participation in the NQDC plan, including \$110,000 of remuneration on June 30, 2023, when the vesting 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 an additional \$5,000 of earnings on the previously paid remuneration (\$110,000) on December 31, 2023.

(iv) Conclusion (2024 applicable year - earnings). For 2024, ATEO 1 pays Employee A \$5,000 of remuneration, the additional earnings on the previously paid remuneration (\$115,000) as of December 31, 2024.

(v) Conclusion (2025 applicable year - losses). For 2025, ATEO 1 pays Employee A no remuneration attributable to Employee A's participation in the NQDC plan since the vested present value of the previously paid remuneration (\$120,000) decreased to \$100,000 as of December 31, 2025. The \$20,000 loss for 2025 does not reduce any amount previously treated as remuneration but is available for carryover to subsequent taxable years to offset earnings.

(vi) Conclusion (2026 applicable year - recovery of losses). For 2026, ATEO 1 pays Employee A no remuneration attributable to Employee A's participation in the NQDC plan because the vested present value of the previously paid remuneration (\$120,000) was \$110,000 as of December 31, 2026. Due to increases on the account balance, ATEO 1 recovers \$10,000 of the \$20,000 of losses carried over from 2025. The net losses as of December 31, 2026, are \$10,000, and none of the \$10,000 in earnings during 2026 is remuneration paid in 2026.

(vii) Conclusion (2027 applicable year - no recovery of losses against additional deferrals of compensation). For 2027, ATEO 1 pays Employee A \$10,000 of remuneration attributable to Employee A's participation in the NQDC plan. 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 credited to Employee A's account. This credit increases the amount of previously paid remuneration from \$120,000 to \$130,000. Additionally, due to earnings, ATEO 1 recovers \$5,000 of the \$10,000 loss carried over from 2026, none of which was remuneration for 2025, so that, as of December 31, 2027, the net loss available for carryover to 2028, is \$5,000.

(viii) Conclusion (2028 applicable year - distributions, recovery of remainder of losses through earnings and additional earnings). For 2028, ATEO 1 pays Employee A \$15,000 in remuneration attributable to Employee A's participation in the NQDC plan. The \$10,000 distribution reduces the amount of previously paid remuneration (from \$130,000 to \$120,000) and the account balance (from \$125,000 to \$115,000). The vested present value of the account balance increases by \$20,000 (from \$115,000 to \$135,000) as of December 31, 2028. Therefore, due to earnings, ATEO 1 recovers the remaining \$5,000 loss carried over from 2027 (the difference between the \$120,000 previously paid remuneration before earnings and the \$115,000 account balance before earnings) and pays Employee A an additional \$15,000 of remuneration as earnings (the difference between the \$135,000 account balance after earnings and the \$120,000 previously paid remuneration after loss recovery).

(2) Example 2 (Nonaccount balance plan with earnings)--(i) Facts. ATEO 2 and CORP 2 are related organizations. Employee B is a covered employee of ATEO 2 and

is also employed by CORP 2. On January 1, 2021, CORP 2 and Employee B enter into an agreement (the agreement) under which CORP 2 will pay Employee B \$100,000 on December 31, 2024, if B remains employed by CORP 2 through January 1, 2023. Employee B remains employed by CORP 2 through January 1, 2023. On January 1, 2023, the present value based on reasonable actuarial assumptions of the \$100,000 to be paid on December 31, 2024, is \$75,000. On December 31, 2023, the vested present value increases to \$85,000 due solely to the passage of time. On December 31, 2024, CORP 2 pays Employee B \$100,000.

(ii) Conclusion (2021 and 2022 applicable years - nonvested amounts). For 2021 and 2022, CORP 2 pays Employee B no remuneration under the agreement because the amount deferred under the agreement remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B).

(iii) Conclusion (2023 applicable year - amounts in year of vesting). For 2023, CORP 2 pays Employee B \$75,000 in remuneration under the agreement on January 1, 2023, which is the vested present value on that date of \$100,000 payable on December 31, 2024. In addition, CORP 2 pays Employee B \$10,000 in remuneration under the agreement on December 31, 2023, as earnings based on the increase in the vested present value of the previously paid remuneration (from \$75,000 to \$85,000) as of December 31, 2023.

(iv) Conclusion (2024 applicable year - earnings and distribution of previously paid remuneration). For 2024, CORP 2 pays Employee B \$15,000 in remuneration under the agreement on December 31, 2024, as earnings based on the increase in the vested present value of the previously paid remuneration (from \$85,000 to \$100,000) as of December 31, 2024. In addition, the \$100,000 distribution is treated as reducing the amount of previously paid remuneration (\$100,000) to zero.

(3) Example 3 (Treatment of amount payable as present value at vesting)--(i) Facts. Employee C is a covered employee of ATEO 3. ATEO 3 uses a calendar year taxable year. Employee C participates in a nonqualified deferred compensation plan (the NQDC plan) under which ATEO 3 agrees to pay Employee C \$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 met. Employee C meets the performance goal on November 30, 2022. In accordance with §53.4960-2(d)(2), because the payment is to be made within 90 days of vesting, ATEO 3 elects to treat the payment amount as the amount paid at vesting.

(ii) Conclusion (2022 applicable year - election to treat amount payable within 90 days as paid at vesting). For taxable year 2022, ATEO 3 pays Employee C \$100,000 of remuneration attributable to Employee C's participation in the NQDC plan. Employee C vests in the \$100,000 payment in 2022 upon meeting the performance goal. Under the general rule, ATEO 3 would be required to treat the present value as of November 30, 2022, of \$100,000 payable in 2023 (two months after the date of vesting) as paid in 2022, the difference between that amount and the present value as of December 31,

2022, as earnings for 2022, and the difference between \$100,000 and the present value as of December 31, 2022, as earnings for 2023. However, because ATEO 3 treated the amount of remuneration payable within 90 days of vesting as the amount paid at vesting in 2022, the entire \$100,000 payable to Employee C in 2023 is treated as remuneration paid in 2022.

(4) Example 4 (Aggregation of pay from related organizations)--(i) Facts. Employee D is a covered employee of ATEO 4 and also an employee of CORP 4 and CORP 5. ATEO 4, CORP 4, and CORP 5 are related organizations. ATEO 4, CORP 4, and CORP 5 each pay Employee D \$200,000 of salary during 2022 and 2023. On January 1, 2022, ATEO 4 promises to pay Employee D \$120,000 on December 31, 2023, under a nonaccount balance plan, the present value of which is \$100,000 on January 1, 2022, and both CORP 4 and CORP 5 contribute \$100,000 on Employee D's behalf to an account balance plan. On December 31, 2022, the present value of the plan maintained by ATEO 4 is \$110,000, the present value of the plan maintained by CORP 4 is \$120,000, and the present value of the plan maintained by CORP 5 is \$90,000. On December 31, 2023, the present value of the plan maintained by ATEO 4 is \$120,000, the present value of the plan maintained by CORP 4 is \$130,000, and the present value of the plan maintained by CORP 5 is \$110,000.

(ii) Conclusion (2022 applicable year). For 2022, before aggregation of remuneration paid by related organizations, ATEO 4 paid Employee D \$310,000 of remuneration (\$200,000 salary + \$100,000 upon vesting + \$10,000 net earnings). CORP 4 paid Employee D \$320,000 of remuneration (\$200,000 salary + \$100,000 upon vesting + \$20,000 net earnings). CORP 5 paid Employee D \$300,000 of remuneration (\$200,000 salary + \$100,000 upon vesting) and has \$10,000 of net losses, which are carried forward to 2023. Thus, ATEO 4 is treated as paying \$930,000 of remuneration to Employee D for the applicable year.

(iii) Conclusion (2023 applicable year). For 2023, before aggregation of remuneration paid by related organizations, ATEO 4 paid Employee D \$210,000 of remuneration (\$200,000 salary + \$10,000 earnings). CORP 4 paid Employee D \$210,000 of remuneration (\$200,000 salary + \$10,000 net earnings). CORP 5 paid Employee D \$300,000 of remuneration (\$200,000 salary + \$10,000 net earnings after taking into account the loss carryforward). Thus, ATEO 4 is treated as paying \$630,000 of remuneration to Employee D for the applicable year.

§53.4960-3 Determination of whether there is a parachute payment.

(a) Parachute payment--(1) In general. Except as otherwise provided in paragraph (a)(2) of this section (relating to payments excluded from the definition of a parachute payment), parachute payment means any payment in the nature of compensation made by an ATEO (or a predecessor of the ATEO) or a related organization to (or for the benefit of) a covered employee if the payment is contingent on the employee's separation from employment with the employer, and 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 3-times the base amount.

(2) Exclusions. The following payments are not parachute payments:

(i) Certain qualified plans. A payment that is a contribution to or a distribution 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);

(ii) Certain annuity contracts. A payment made under or to an annuity contract described in section 403(b) or a plan described in section 457(b);

(iii) Compensation for medical services. A payment made to a licensed medical professional for the performance of medical services performed by such professional; and

(iv) Payments to non-HCEs. A payment made to an individual who is not a highly compensated employee (HCE) as defined in paragraph (a)(3) of this section.

(3) Determination of HCEs for purposes of the exclusion from parachute payments. For purposes of this section, highly compensated employee or HCE means, with regard to an ATEO that maintains a qualified retirement plan or other employee benefit plan described in §1.414(q)-1T, Q/A-1, any person who is a highly compensated employee within the meaning of section 414(q) and, with regard to an ATEO that does not maintain such a plan, any person who would be a highly compensated employee within the meaning of section 414(q) if the ATEO did maintain such a plan. For purposes of determining the group of highly compensated employees for a determination year, consistent with §1.414(q)-1T, Q/A-14(a)(1), the determination year calculation is made on the basis of the applicable plan year under §1.414(q)-1T, Q/A-14(a)(2) 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. For an ATEO that does not maintain a plan described in §1.414(q)-1T, Q/A-1, the rules are applied by analogy, substituting the calendar year for the plan year. Thus, for example, in 2021, an ATEO that does not maintain such a plan must use its employees' 2020 annual compensation (as defined in §1.414(q)-1T, Q/A-13, including any of the safe harbor definitions if applied consistently to all employees) to determine which employees are HCEs for 2021, if any, for purposes of section 4960. If an employee is an HCE at the time of separation from employment, then for purposes of section 4960 any parachute payment that is contingent on the separation from employment (as defined in paragraph (d) of this section) is treated as paid to an HCE so that the exception from the term parachute payment under paragraph (a)(2)(iv) of this section does not apply, even if the payment occurs during one or more later taxable

years (that is, taxable years after the taxable year during which the employee separated from employment).

(b) Payment in the nature of compensation--(1) In general. 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, a payment made under a covenant not to compete or a similar arrangement is a payment 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, the value of accelerated vesting, or a transfer of property. The vesting of an option, stock appreciation right, or similar form of compensation as a result of a covered employee's separation from employment is a payment in the nature of compensation. 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 parachute payment will be made.

(2) 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.

(c) When payment is considered to be made--(1) 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 or, in the case of fringe benefits and other benefits that are excludible from income, in the taxable year the benefits are received. In the case of taxable non-cash fringe benefits provided in a calendar year, payment is considered made on the date or dates the employer chooses, but no later than December 31 of the calendar year in which the benefits are provided, except that when the fringe benefit is the transfer of personal property (either tangible or intangible) of a kind normally held for investment or the transfer of real property, payment is considered made on the actual date of transfer. If the fringe benefit is neither a transfer of personal property nor a transfer of real property, the employer may, in its discretion, treat the value of the benefit actually provided during the last two months of the calendar year as paid during the subsequent calendar year. However, an employer that treats the value of a benefit paid during the last two months of a calendar year as paid during the subsequent calendar year under this rule must treat the value of that fringe benefit as paid during the subsequent calendar year with respect to all employees who receive it.

(2) 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, disregarding any election made by the employee under section 83(b) or (i). Thus, in general, such a payment is considered made at the later of the date the property is transferred (as defined in §1.83-3(a)) to the covered employee or the date the property becomes substantially vested (as defined in

§§1.83-3(b) and (j)). The amount of the payment is the compensation as determined under section 83, disregarding any amount includible in income pursuant to an election made by an employee under section 83(b).

(3) Stock options and stock appreciation rights. 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 §1.83-7(b)). For purposes of determining the timing and amount of any payment related to the option, the principles of §1.280G-1, Q/A-13 and any method prescribed by the Commissioner in published guidance of general applicability under §601.601(d)(2) apply.

(d) Payment contingent on an employee's separation from employment--(1) 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 the employee's involuntary separation from employment. A payment generally would be made in the absence of the employee's involuntary separation from employment if it is substantially certain at the time of the involuntary separation from employment that the payment would be made whether or not the involuntary separation occurred. 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 an involuntary separation from employment (and is therefore not contingent on a separation from employment), except that the increased value of an accelerated payment of a vested amount described in paragraph (f)(3) of this section resulting from

an involuntary separation from employment is not treated as a payment that would have been made in the absence of an involuntary 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 is accelerated due to the separation from employment as described in paragraph (f)(3) of this section, 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 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. See paragraph (d)(3) of this section for the treatment of a payment made pursuant to a covenant not to compete. If, after an involuntary separation from employment, the former employee continues to provide certain services as a nonemployee, payments for services rendered as a nonemployee are not payments that are contingent on a separation from employment to the extent those payments are reasonable and are not made on account of the involuntary separation from employment. Whether services are performed as an employee or nonemployee depends upon all the facts and circumstances. See §53.4960-1(e). For rules on determining whether payments are reasonable compensation for services, the rules of §1.280G-1, Q/A-40 through Q/A-42 (excluding Q/A-40(b) and Q/A-42(b)), and Q/A-44 are applied by analogy (substituting involuntary separation from employment for change in ownership or control).

(2) Employment agreements--(i) In general. 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, the payment of damages is treated as a payment that is contingent on a separation from employment. An employment agreement is 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.

(ii) Example. The following example illustrates the rules of this paragraph (d)(2). For purposes of this example, assume any entity referred to as "ATEO" is an ATEO.

(A) Example--(1) Facts. Employee A, a covered employee, has a three-year employment agreement with ATEO 1. Under the agreement, Employee A will receive a salary of \$200,000 for the first year and, for each succeeding year, an annual salary that is \$100,000 more than the previous year. The agreement provides that, in the event of A's involuntary separation from employment without cause, Employee A will receive the remaining salary due under the agreement. At the beginning of the second year of the agreement, ATEO 1 involuntarily terminates Employee A's employment without cause and pays Employee A \$700,000 representing the remaining salary due under the employment agreement (\$300,000 for the second year of the agreement plus \$400,000 for the third year of the agreement).

(2) Conclusion. The \$700,000 payment is treated as a payment that is contingent on a separation from employment.

(3) 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 if the payment would not have been made in the absence of an involuntary separation from employment. For example, a payment contingent on compliance in whole or in part with a covenant not to compete negotiated as part of a severance arrangement arising from an involuntary separation from employment is contingent on a separation from

employment. Similarly, one or more payments contingent on compliance in whole or in part with a covenant not to compete not negotiated as part of a severance arrangement arising from an involuntary separation from employment but that provides for a payment specific to an involuntary separation from employment (and not voluntary separation from employment) is contingent on a separation from employment. Payments made under an agreement requiring a covered employee to refrain from performing services that are contingent on separation from employment are not treated as paid in exchange for the performance of services and are not excluded from parachute payments.

(4) Payment of amounts previously included in income or excess remuneration.

Actual or constructive payment of an amount that was previously included in gross income of the employee is not a payment contingent on a separation from employment. For example, payment of an amount included 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 generally 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 receipt of an amount treated as excess remuneration under §53.4960-4(a)(1) 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.

(5) Window programs. A payment under a window program is contingent on a separation from employment. A window program is a program established by an employer in connection with an impending separation from employment to provide separation pay if 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.

(6) Anti-abuse provision. Notwithstanding paragraphs (d)(1) through (5) of this section, if the facts and circumstances demonstrate that either the vesting or the payment of an amount (whether before or after an employee's involuntary separation from employment) would not have occurred but for the involuntary nature of the separation from employment, the payment of the amount is 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 was therefore 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 was therefore contingent on the employee's separation from employment. If an ATEO becomes a predecessor as a result of a reorganization or other transaction described in §53.4960-1(h), any payment to an employee by a successor organization that is contingent on the employee's separation from employment with the predecessor ATEO is treated as paid by the predecessor ATEO.

(e) Involuntary separation from employment--(1) In general. 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 as an employee. 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.

(2) Separation from employment for good reason--(i) In general. Notwithstanding paragraph (e)(1) of this section, an employee's voluntary separation from employment is treated as an involuntary separation from employment if the separation occurs under certain bona fide conditions (referred to herein as a separation from employment for good reason).

(ii) Material negative change required. A separation from employment for good reason is treated as an involuntary separation from employment if the relevant facts and circumstances demonstrate that it was the result of unilateral employer action that caused a material negative change to the employee's relationship with the employer. Factors that may provide evidence of such a material negative change include a material reduction in the duties to be performed, a material negative change in the conditions under which the duties are to be performed, or a material reduction in the compensation to be received for performing such services.

(iii) Deemed material negative change. An involuntary separation from employment due to a material negative change is deemed to occur if the separation from employment occurs within two years following the initial existence of one or more of the following conditions arising without the consent of the employee:

(A) Material diminution of compensation. A material diminution in the employee's base compensation;

(B) Material diminution of responsibility. A material diminution in the employee's authority, duties, or responsibilities;

(C) Material diminution of authority of supervisor. A material diminution in the authority, duties, or responsibilities of the supervisor to whom the employee is required to report, including a requirement that an employee report to a corporate officer or employee instead of reporting directly to the board of directors (or similar governing body) of an organization;

(D) Material diminution of budget. A material diminution in the budget over which the employee retains authority;

(E) Material change of location. A material change in the geographic location at which the employee must perform services; or

(F) Other material breach. Any other action or inaction that constitutes a material breach by the employer of the agreement under which the employee provides services.

(3) Separation from employment. Except as otherwise provided in this paragraph, separation from employment has the same meaning as separation from service as defined in §1.409A-1(h). Pursuant to §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 or experiences a sufficient reduction in the level of services provided to the employer. For purposes of applying the rules regarding reductions in the level of services set forth in the definition of termination of employment in §1.409A-1(h)(1)(ii), the rules are modified for purposes of this paragraph 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, meaning that the default percentages set forth in §1.409A-1(h)(1)(ii) apply in all circumstances. 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 separation from employment, and the treatment of an anticipated reduction between those two levels is determined based on the facts and circumstances. The measurement of the anticipated reduction of the level of service is based on the average level of service for the prior 36 months (or shorter period for an employee employed for less than 36 months). In addition, an employee's separation from employment is determined without regard to §1.409A-1(h)(2) and (5) (application to independent contractors), since, for purposes of this section, only an employee may have a separation from employment, and a change from bona fide employee status to bona fide independent contractor status is also a separation from employment. See §53.4960-2(a)(1) regarding the treatment of an employee who also serves as a director of a corporation (or in a substantially similar position). The definition of separation from employment also incorporates the rules under §1.409A-1(h)(1)(i) (addressing leaves of absence, including military leaves of absence), §1.409A-1(h)(4) (addressing asset purchase transactions), and §1.409A-1(h)(6) (addressing employees participating in

collectively bargained plans covering multiple employers). The definition further incorporates the rules of §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 sections 414(b) and (c), except that the “at least 80 percent” rule under sections 414(b) and (c) is used, 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 is 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.

(f) Accelerated payment or accelerated vesting resulting from an involuntary separation from employment--(1) In general. If a payment or the lapse of a substantial risk of forfeiture is accelerated as a result of an involuntary separation from employment, generally only the value due to the acceleration of payment or vesting is treated as contingent on a separation from employment, as described in paragraphs (f)(3) and (4) of this section, except as otherwise provided in this paragraph (f). For purposes of this paragraph (f), the terms vested and substantial risk of forfeiture have the same meaning as provided in §53.4960-2(c)(2).

(2) Nonvested payments subject to a non-service vesting condition. If (without regard to a separation from employment) vesting of a payment would depend on an event other than the performance of services, such as the attainment of a performance

goal, and that vesting event does not occur prior to the employee's separation from employment and the payment vests due to the employee's involuntary separation from employment, the full amount of the payment is treated as contingent on the separation from employment.

(3) Vested payments. If an involuntary separation from employment accelerates actual or constructive payment of an amount that previously 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. 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 unless the payment timing was 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 purposes of this paragraph (f)(3), 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 paragraph (f)(6) and paragraphs (h), (i) and (j) of this section.

(4) Nonvested payments subject to a service vesting condition--(i) In general. If an involuntary separation from employment accelerates vesting of a payment, the portion of the payment that is contingent on separation from employment is the amount described in paragraph (f)(3) of this section (if any) plus the value of the lapse of the obligation to continue to perform services described in paragraph (f)(4)(ii) of this section (but the amount cannot exceed the amount of the accelerated payment, or, if the payment is not accelerated, the present value of the payment), to the extent that all of the following conditions are satisfied with respect to the payment:

(A) Vesting trigger. The payment vests as a result of an involuntary separation from employment;

(B) Vesting condition. Disregarding the involuntary separation from employment, the vesting of the payment was contingent only on the continued performance of services for the employer for a specified period of time; and

(C) Services condition. 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.

(ii) Value of the lapse of the obligation to continue to perform services. The value of the lapse of the obligation to continue to perform services 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 (f)(4)(ii)

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 value of 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.

(iii) Accelerated vesting of equity compensation. For purposes of this paragraph (f)(4), the acceleration of the vesting of a stock option or stock appreciation right (or similar arrangement) or the lapse of a restriction on restricted stock or a restricted stock unit (or a similar arrangement) is considered to significantly increase the value of the payment.

(5) Application to benefits under a nonqualified deferred compensation plan. In the case of a payment of benefits under a nonqualified deferred compensation plan, paragraph (f)(3) of this section applies to the extent benefits under the plan are vested without regard to the involuntary separation from employment, but the payment of benefits is accelerated due to the involuntary separation from employment. Paragraph (f)(4) of this section applies to the extent benefits under the plan are subject to the conditions described in paragraph (f)(4)(i) of this section. 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.

(6) Present value. For purposes of this paragraph (f), the present value of a payment is determined based on the payment date absent the acceleration and the date

on which the accelerated payment is scheduled to be 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.

(7) Examples. See §1.280G Q/A-24(f) for examples that may be applied by analogy to illustrate the rules of this paragraph (f).

(g) Three-times-base-amount test for parachute payments--(1) 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, the aggregate present value of the payments 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 3-times the individual's base amount, the payments are parachute payments. If this aggregate present value is less than the amount equal to 3-times the individual's base amount, the payments are not parachute payments. See paragraphs (f)(6), (h), (i), and (j) of this section for rules on determining present value.

(2) Examples. The following examples illustrate the rules of this paragraph (g). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO.

(i) Example 1 (Parachute payment)--(A) Facts. Employee A is a covered employee and an HCE of ATEO 1. Employee A's base amount is \$200,000. Payments in the nature of compensation that are contingent on a separation from employment with

ATEO 1 totaling \$800,000 are made to Employee A on the date of Employee A's separation from employment.

(B) Conclusion. The payments are parachute payments because they have an aggregate present value at the time of the separation from employment of \$800,000, which is at least equal to 3-times Employee A's base amount of \$200,000 ($3 \times \$200,000 = \$600,000$).

(ii) Example 2 (No parachute payment)--(A) Facts. Assume the same facts as in paragraph (g)(2)(i) of this section (Example 1), except that the payments contingent on Employee A's separation from employment total \$580,000.

(B) Conclusion. Because the aggregate present value of the payments (\$580,000) is not at least equal to 3-times Employee A's base amount (\$600,000), the payments are not parachute payments.

(h) Calculating present value--(1) In general. Except as otherwise provided in this paragraph (h), for purposes of determining if a payment contingent on a separation from employment exceeds 3-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.

(2) 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 paragraph (i) of this section.

(3) 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 paragraph (h) and for applying the 3-times-base-amount test

under paragraph (g) of this section, the present value of the obligation is calculated in accordance with generally accepted accounting principles. For purposes of paragraph (g) of this section and this paragraph (h), 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 purposes of this paragraph (h)(3) may be the allocable portion of group premiums.

(i) Discount rate. 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 in part 1 under section 1274(d)), 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 paragraph (h) of this section for rules with respect to the date as of which the present value is determined. 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 on which the parties entered into the contract that provides for the payment if that election is set forth in writing in the contract.

(j) Present value of a payment to be made in the future that is contingent on an uncertain future event or condition--(1) Treatment based on the estimated probability of payment. In certain cases, it may be necessary to apply the 3-times-base-amount test 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 3-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.

(2) Correction of incorrect estimates. If an ATEO later determines that an estimate it made under paragraph (j)(1) of this section was incorrect, it must reapply the 3-times-base-amount test to reflect the actual time and amount of the payment. In reapplying the 3-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 paragraph (h) of this section using the discount rate described in paragraph (i) of this section. This redetermination may affect the amount of any excess parachute payment for a prior taxable year. However, if, based on the application of the 3-times-base-amount test without regard to the payment described in this paragraph (j), an ATEO has determined it will pay an employee an excess parachute payment or payments, then the 3-times-base-amount test does not have to be reapplied when a payment described in this paragraph (j) is made (or becomes certain to be made) if no base amount is allocated to that payment under §53.4960-4(d)(6).

(3) Initial option value estimate. To the extent provided in published guidance of general applicability under §601.601(d)(2), an initial estimate of the value of an option subject to paragraph (c) of this section is permitted to be made, with the valuation subsequently redetermined and the 3-times-base-amount test reapplied. Until guidance is published under section 4960, published guidance of general applicability described in §601.601(d)(2) that is issued under section 280G applies by analogy.

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

(k) Base amount--(1) 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 of the ATEO), and/or, if applicable, 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 that would have been includible in the individual's gross income if the individual had been a United States citizen or resident. See paragraph (l) of this section for the definition of base period and for examples of base amount computations.

(2) 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.

(3) 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 may constitute parachute payments. For example, payments in the form of excludable fringe benefits or excludable health care benefits are not included in the base amount but may be treated as parachute payments.

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

(l) Base period--(1) 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, or a related organization.

(2) Determination of base amount if employee separates from employment in the year hired. If a covered employee commences services as an employee and experiences a separation from employment in the same taxable year, the covered employee's base amount is the annualized compensation for services performed for the ATEO (or a predecessor or related organization) that was not contingent on the separation from employment and either 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.

(3) Examples. The following examples illustrate the rules of paragraph (k) of this section and this paragraph (l). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO, any entity referred to as "CORP" is not an ATEO, and all employees are HCEs of their respective employers.

(i) Example 1 (Calculation with salary deferrals)--(A) Facts. Employee A, a covered employee of ATEO 1, receives an annual salary of \$500,000 per year during the five-year base period. Employee A defers \$100,000 of salary each year under a nonqualified deferred compensation plan (none of which is includible in Employee A's income until paid in cash to Employee A).

(B) Conclusion. Employee A's base amount is \$400,000 ($(\$400,000 \times 5) / 5$).

(ii) Example 2 (Calculation for less-than-five-year base period)--(A) Facts. Employee B, a covered employee of ATEO 1, was employed by ATEO 1 for two years and four months preceding the year in which Employee B separates from employment. Employee B'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.

(B) Conclusion. Employee B's base amount is \$390,000 ($((3 \times \$100,000) + \$420,000 + \$450,000) / 3$). Any compensation Employee B receives in the year of separation from employment is not included in the base amount calculation.

(iii) Example 3 (Calculation for less-than-five-year base period with signing bonus)--(A) Facts. Assume the same facts as in paragraph (l)(3)(ii)(A) of this section (Example 2), except that Employee B also received a \$60,000 signing bonus when Employee B's employment with ATEO 1 commenced at the beginning of the four-month period.

(B) Conclusion. Employee B's base amount is \$410,000 ($(\$60,000 + (3 \times \$100,000) + \$420,000 + \$450,000) / 3$). Pursuant to paragraph (k)(2) of this section, because 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 Employee B's compensation for the four-month period.

(iv) Example 4 (Effect of non-employee compensation)--(A) Facts. Employee C, a covered employee of ATEO 1, was not an employee of ATEO 1 for the full five-year base period. In 2024 and 2025, Employee C is only a director of ATEO 1 and receives \$30,000 per year for services as a director. On January 1, 2026, Employee C becomes

an officer and covered employee of ATEO 1. Employee C's includible compensation for services as an officer of ATEO 1 is \$250,000 for each of 2026 and 2027, and \$300,000 for 2028. In 2028, Employee C separates from employment with ATEO 1.

(B) Conclusion. Employee C's base amount is \$250,000 $((2 \times \$250,000) / 2)$. The \$30,000 received in each of 2024 and 2025 is not included in Employee C's base amount calculation because it was not for services performed as an employee of ATEO 1.

§53.4960-4 Liability for tax on excess remuneration and excess parachute payments.

(a) Liability, reporting, and payment of excise taxes--(1) Liability. For each taxable year, with respect to each covered employee, the taxpayer is liable for tax at the rate imposed under section 11 on the sum of the excess remuneration allocated to the taxpayer under paragraph (c) of this section with respect to any applicable year ending with or within the taxable year and, if the taxpayer is an ATEO, any excess parachute payment paid by the taxpayer or a predecessor during the taxable year.

(2) Reporting and payment. Taxes imposed under paragraph (a)(1) of this section are reported and paid in the form and manner prescribed by the Commissioner.

(3) 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 paragraph (a) of this section is separate from, and unaffected by, any arrangement that an ATEO and any related organization may have for bearing the cost of any excise tax liability under section 4960.

(b) Amounts subject to tax--(1) Excess remuneration--(i) In general. Excess remuneration means the amount of remuneration paid by an ATEO to any covered employee during an applicable year in excess of \$1 million, as determined under §53.4960-2.

(ii) Exclusion for excess parachute payments. Excess remuneration does not include any amount that is an excess parachute payment as defined in paragraph (b)(2) of this section.

(2) Excess parachute payment. Excess parachute payment means an amount equal to the excess (if any) of the amount of any parachute payment paid by an ATEO, a predecessor of the ATEO, or a related organization, or on behalf of an any such person, during the taxable year over the portion of the base amount allocated to such payment.

(c) Calculation of liability for tax on excess remuneration--(1) In general. If, for the taxable year, remuneration paid during an applicable year by more than one employer to a covered employee is taken into account in determining the tax imposed on excess remuneration for such taxable year, then the taxpayer is liable for the tax in an amount which bears the same ratio to the total tax determined under section 4960(a) as the amount of remuneration paid by the taxpayer (as an employer) to the covered employee (including remuneration deemed paid by the employer under §53.4960-2(b)(1), but disregarding remuneration treated as paid by the employer under §53.4960-2(b)(2)), bears to the total amount of remuneration paid by the ATEO under §53.4960-2 (including remuneration treated as paid by the ATEO under §53.4960-2(b)(2)). This process is repeated for each ATEO of which the employee is a covered employee, notwithstanding paragraph (c)(2) of this section.

(2) Calculation of the tax for overlapping groups of related organizations--(i) In general. If, with respect to a covered employee, a taxpayer is liable for the excise tax on excess remuneration in its capacity both as an ATEO and as a related organization, or as an organization that is related to more than one ATEO, then, with respect to the covered employee, the taxpayer is liable for the excise tax only in the capacity in which it is liable for the greatest amount of excise tax for the taxable year, whether as an

ATEO or as a related organization. For example, assume ATEO 1 is a related organization to both ATEO 2 and ATEO 3 and pays excess remuneration to Employee D, and Employee D is a covered employee of ATEO 1, ATEO 2, and ATEO 3. In this case, ATEO 1's liability for excise tax on excess remuneration to Employee D is the highest of its liability as an ATEO, as a related organization to ATEO 2, or as a related organization to ATEO 3.

(ii) Calculation when an ATEO has a short applicable year. If an ATEO has a short applicable year under §53.4960-1(c)(3), then a related organization must determine the capacity in which it is liable for the greatest amount of excise tax for the taxable year under paragraph (c)(2)(i) of this section by comparing its liability for the short applicable year with its liability for any other related ATEO's applicable year (and, if the related organization is also an ATEO, its own applicable year) beginning or ending on the same date as the short applicable year, as appropriate.

(3) Examples. The following examples illustrate the rules of this paragraph (c). For purposes of these examples, assume that the rate of excise tax under section 4960 is 21 percent, that any entity that is referred to as "ATEO" is an ATEO, that any entity referred to as "CORP" is not an ATEO and is not a publicly held corporation or a covered health insurance provider within the meaning of section 162(m)(2) or (m)(6)(C) respectively, and that no parachute payments are made in any of the years at issue.

(i) Example 1 (Remuneration from multiple employers)--(A) Facts. ATEO 1 and CORP 1 are related organizations. Employee A is a covered employee of ATEO 1 and an employee of CORP 1. In the 2021 applicable year, ATEO 1 pays Employee A \$1.2 million of remuneration, and CORP 1 pays A \$800,000 of remuneration.

(B) Conclusion. For the 2021 applicable year, ATEO 1 is treated as paying Employee A \$2 million of remuneration, \$1 million of which is excess remuneration. The total excise tax is \$210,000 (21 percent x \$1 million). ATEO 1 paid 3/5 of Employee A's

total remuneration (\$1.2 million / \$2 million); thus, ATEO 1 is liable for 3/5 of the excise tax, which is \$126,000. CORP 1 paid 2/5 of Employee A's total remuneration (\$800,000 / \$2 million); thus, CORP 1 is liable for 2/5 of the excise tax, which is \$84,000.

(ii) Example 2 (Multiple liabilities for same applicable year due to overlapping related organization groups)--(A) Facts. The following facts are all with respect to the 2021 applicable year: ATEO 5 owns 60 percent of the stock of CORP 2. Sixty percent of ATEO 4's directors are representatives of ATEO 3. In addition, 60 percent of ATEO 5's directors are representatives of ATEO 4, but none are representatives of ATEO 3. Employee B is a covered employee of ATEO 3, ATEO 4, and ATEO 5 and is an employee of CORP 2. ATEO 3, ATEO 4, ATEO 5, and CORP 2 each pay Employee B \$1.2 million of remuneration in the applicable year. ATEO 4's related organizations are ATEO 3 and ATEO 5. ATEO 3's only related organization is ATEO 4. ATEO 5's related organizations are ATEO 4 and CORP 2.

(B) Calculation (ATEO 3). Under ATEO 3's calculation as an ATEO, ATEO 3 is treated as paying Employee B a total of \$2.4 million in remuneration (\$1.2 million from ATEO 3 + \$1.2 million from ATEO 4). The total excise tax is \$294,000 (21 percent X \$1.4 million). ATEO 3 and ATEO 4 each paid 1/2 of Employee B's total remuneration (\$1.2 million / \$2.4 million); thus, under ATEO 3's calculation, ATEO 3 and ATEO 4 each would be liable for 1/2 of the excise tax, which is \$147,000.

(C) Calculation (ATEO 4). Under ATEO 4's calculation as an ATEO, ATEO 4 is treated as paying Employee B a total of \$3.6 million in remuneration for the 2021 applicable year (\$1.2 million from ATEO 3 + \$1.2 million from ATEO 4 + \$1.2 million from ATEO 5). The total excise tax is \$546,000 (21 percent X \$2.6 million). ATEO 3, ATEO 4, and ATEO 5 each paid 1/3 of the total remuneration to Employee B (\$1.2 million / \$3.6 million); thus, under ATEO 4's calculation, ATEO 3, ATEO 4, and ATEO 5 each would be liable for 1/3 of the excise tax, which is \$182,000.

(D) Calculation (ATEO 5). Under ATEO 5's calculation as an ATEO, ATEO 5 is treated as paying Employee B a total of \$3.6 million in remuneration (\$1.2 million from ATEO 4 + \$1.2 million from ATEO 5 + \$1.2 million from CORP 2). The total excise tax is \$546,000 (21 percent X \$2.6 million). ATEO 4, ATEO 5, and CORP 2 each paid 1/3 of the total remuneration to Employee B (\$1.2 million / \$3.6 million); thus, under ATEO 5's calculation, ATEO 4, ATEO 5, and CORP 2 each would be liable for 1/3 of the excise tax, which is \$182,000.

(E) Conclusion (Liability of ATEO 3). ATEO 3 is liable for \$182,000 of excise tax as a related organization under ATEO 4's calculation, which is greater than the \$147,000 of excise tax ATEO 3 calculated under ATEO 3's own calculation. Thus, ATEO 3's excise tax liability is \$182,000.

(F) Conclusion (Liability of ATEO 4). ATEO 4 is liable as a related organization for \$147,000 of excise tax according to ATEO 3's calculation, for \$182,000 according to

ATEO 4's own calculation, and for \$182,000 according to ATEO 5's calculation. Thus, ATEO 4's excise tax liability is \$182,000.

(G) Conclusion (Liability of ATEO 5). ATEO 5 is liable as a related organization for \$182,000 of excise tax under ATEO 4's calculation and is liable for \$182,000 of excise tax under ATEO 5's own calculation. Thus, ATEO 5's excise tax liability is \$182,000.

(H) Conclusion (Liability of CORP 2). CORP 2 is liable as a related organization for \$182,000 of excise tax according to ATEO 5's calculation. Thus, CORP 2's excise tax liability is \$182,000.

(iii) Example 3 (Liabilities for a short applicable year resulting from a termination of ATEO status)--(A) Facts. ATEO 6 and CORP 3 are related organizations that use a calendar year taxable year. Employee C is a covered employee of ATEO 6 and an employee of CORP 3. ATEO 6 has a termination of ATEO status on June 30, 2022. From January 1 through June 30, 2022, ATEO 6 paid Employee C \$1 million of remuneration and CORP 3 paid Employee C \$1 million of remuneration. From July 1 through December 31, 2022, ATEO 6 paid Employee C no remuneration and CORP 3 paid Employee C \$1 million of remuneration.

(B) Conclusion (ATEO 6). For ATEO 6's taxable year starting January 1, 2022, and ending June 30, 2022, ATEO 6 is treated as paying \$2 million of remuneration to Employee C (\$1 million from ATEO 6 + \$1 million from CORP 3), \$1 million of which is excess remuneration. ATEO 6 is thus liable for 1/2 of the excise tax, which is \$105,000 ($\$500,000 \times 21$ percent).

(C) Conclusion (CORP 3). For CORP 3's taxable year starting January 1, 2022, and ending December 31, 2022, only ATEO 6's applicable year ending June 30 ends with or within the taxable year. CORP 3 is allocated liability for the tax with respect to remuneration treated as paid by ATEO 6 during its applicable year starting January 1, 2022 and ending June 30, 2022. CORP 3 is thus liable for 1/2 of the excise tax, which is \$105,000 ($\$500,000 \times 21$ percent).

(iv) Example 4 (Multiple liabilities where there is a short applicable year resulting from a termination of ATEO status)--(A) Facts. Assume the same facts as in paragraph (c)(3)(iii) of this section (Example 3), except that ATEO 7 is also a related organization of ATEO 6 and CORP 3 and paid Employee C \$1 million of remuneration between January 1, 2022, and June 30, 2022. ATEO 7 also paid Employee C \$1 million of remuneration between July 1 and December 31, 2022.

(B) Calculation (ATEO 6). Under ATEO 6's calculation as an ATEO, ATEO 6 is treated as paying Employee C a total of \$3 million in remuneration for the applicable year starting January 1, 2022, and ending June 30, 2022 (\$1 million from ATEO 6 + \$1 million from ATEO 7 + \$1 million from CORP 3), \$2 million of which is excess remuneration. The total excise tax is \$420,000 (21 percent X \$2 million). ATEO 6,

ATEO 7, and CORP 3 each paid 1/3 of the total remuneration to Employee C (\$1 million / \$3 million); thus, under ATEO 6's calculation, ATEO 6, ATEO 7, and CORP 3 each would be liable for 1/3 of the excise tax, which is \$140,000.

(C) Calculation (ATEO 7). Under ATEO 7's calculation as an ATEO, ATEO 7 is treated as paying Employee C a total of \$5 million in remuneration for the applicable year starting January 1, 2022, and ending December 31, 2022 (\$1 million from ATEO 6 + \$2 million from ATEO 7 + \$2 million from CORP 3), \$4 million of which is excess remuneration. The total excise tax is \$840,000 (21 percent X \$4 million). ATEO 6 paid 1/5 of the total remuneration to Employee C (\$1 million / \$5 million), and ATEO 7 and CORP 3 each paid 2/5 of the total remuneration (\$2 million / \$5 million; thus, under ATEO 7's calculation, ATEO 6 would be liable for 1/5 of the excise tax, which is \$168,000, and ATEO 7 and CORP 3 each would be liable for 2/5 of the excise tax, which is \$336,000.

(D) Conclusion (Liability of ATEO 6, ATEO 7, and CORP 3). Only ATEO 6's applicable year starting January 1, 2022 and ending June 30, 2022, ended with or within ATEO 6's taxable year starting January 1, 2022, and ending June 30, 2022; thus, ATEO 6 is liable for \$140,000 of excise tax under ATEO 6's own calculation.

(E) Conclusion (Liability of ATEO 7). ATEO 7 is liable as a related organization for \$140,000 of excise tax according to ATEO 6's calculation for the applicable year ending June 30, 2022, but is liable for \$336,000 according to ATEO 7's own calculation for the applicable year ending December 31, 2022. Thus, ATEO 7's excise tax liability is \$336,000.

(F) Conclusion (Liability of CORP 3). CORP 3 is liable as a related organization for \$140,000 of excise tax according to ATEO 6's calculation for the applicable year ending June 30, 2022, but is liable for \$336,000 according to ATEO 7's calculation for the applicable year ending December 31, 2022. Thus, CORP 3's excise tax liability is \$336,000.

(v) Example 5 (Liability when there are multiple applicable years for a taxable year)--(A) Facts. Assume the same facts as in paragraph (c)(3)(iii) of this section (Example 3), except that ATEO 6, and CORP 3 each use a taxable year that starts on October 1 and ends on September 30. In 2021, ATEO 6 paid C \$2 million and CORP 3 paid Employee C \$2 million.

(B) Conclusion (ATEO 6). For ATEO 6's taxable year starting October 1, 2021, and ending June 30, 2022 (the date of termination of ATEO status), two applicable years end with or within the taxable year. Thus, ATEO 6 must determine the amount of remuneration that it is treated as paying for each separate applicable year. For the 2021 applicable year (full year), ATEO 6 is treated as paying \$4 million of remuneration to Employee C (\$2 million from ATEO 6 + \$2 million from CORP 3), \$3 million of which is excess remuneration. ATEO 6 is thus liable for \$315,000, which is 1/2 of the overall excise tax (\$3 million excess remuneration x 21 percent = \$630,000 x 1/2). For the 2022

applicable year (January 1 through June 30), ATEO 6 is treated as paying \$2 million of remuneration to Employee C (\$1 million from ATEO 6 + \$1 million from CORP 3), \$1 million of which is excess remuneration. ATEO 6 is thus liable for \$105,000, which is 1/2 of the overall excise tax (\$1 million excess remuneration x 21 percent = \$210,000 x 1/2). Accordingly, ATEO 6 is liable for \$420,000 total excise tax for the taxable year starting October 1, 2021, and ending June 30, 2022

(C) Conclusion (CORP 3). For CORP 3's taxable year starting October 1, 2021, and ending September 30, 2022, both of ATEO 6's most recent applicable years end with or within its taxable year. CORP 3 is allocated liability for the tax with regard to remuneration treated as paid by ATEO 6 during both applicable years. CORP 3 is thus liable for 1/2 of the excise tax for the 2021 applicable year, which is \$315,000 (\$3 million x 21 percent = \$630,000 x 1/2), and 1/2 of the excise tax for the 2022 applicable year, which is \$105,000 (\$1 million x 21 percent = \$210,000 x 1/2).

(d) Calculation of liability for excess parachute payments--(1) In general. Except as provided in paragraph (d)(4) of this section, only excess parachute payments made by or on behalf of an ATEO are subject to tax under this section. However, parachute payments made by related organizations that are not made by or on behalf of an ATEO are taken into account for purposes of determining the total amount of excess parachute payments.

(2) Computation of excess parachute payments--(i) Calculation. The amount of an excess parachute payment is the excess of the amount of any parachute payment made by an ATEO, a predecessor of the ATEO, or a related organization, or on behalf of any such person, over the portion of the covered employee's base amount that is allocated to the payment. 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.

(3) Examples. The following examples illustrate the rules of this paragraph (d)(2).

For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO and all employees are HCEs of their respective employers.

(i) Example 1 (Compensation from related organizations)--(A) Facts. ATEO 1 and ATEO 2 are related organizations. Employee A is a covered employee of ATEO 1 and an employee of ATEO 2 who has an involuntary separation from employment with ATEO 1 and ATEO 2. Employee A’s base amount is \$200,000 with respect to ATEO 1 and \$400,000 with respect to ATEO 2. A receives \$1 million from ATEO 1 contingent upon Employee A’s involuntary separation from employment from ATEO 1 and \$1 million contingent upon Employee A’s involuntary separation from employment from ATEO 2.

(B) Conclusion. Employee A 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 3-times Employee A’s base amount ($3 \times \$600,000 = \1.8 million). The portion of the base amount allocated to each parachute payment is \$300,000 ($(\$1 \text{ million} / \$2 \text{ million}) \times \$600,000$). Thus, the amount of each excess parachute payment is \$700,000 ($\$1 \text{ million} - \$300,000$).

(ii) Example 2 (Multiple parachute payments)--(A) Facts. Employee B is a covered employee of ATEO 3 with a base amount of \$200,000 who 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.

(B) Conclusion. The portion of the base amount allocated to the first payment is \$40,000 ($(\$200,000 \text{ present value of the parachute payment} / \$1 \text{ million present value of all parachute payments}) \times \$200,000 \text{ total base amount}$) and the portion of the base amount allocated to the second payment is \$160,000 ($(\$800,000 \text{ present value of the parachute payment} / \$1 \text{ million present value of all parachute payments}) \times \$200,000 \text{ total base amount}$), respectively. Thus, the amount of the first excess parachute payment is \$160,000 ($\$200,000 - \$40,000$) and that the amount of the second excess parachute payment is \$740,000 ($\$900,000 - \$160,000$).

(4) Reallocation when the payment is disproportionate to base amount. In

accordance with section 4960(d), the Commissioner may treat a parachute payment as

paid by an ATEO if the facts and circumstances indicate that the ATEO and other payors of parachute payments structured the payments in a manner primarily to avoid liability under section 4960. For example, if an ATEO would otherwise be treated as paying a portion of an excess parachute payment in an amount that is materially lower in proportion to the total excess parachute payment than the proportion that the amount of average annual compensation paid by the ATEO (or any predecessor) during the base period bears to the total average annual compensation paid by the ATEO (or any predecessor) and any related organization (or organizations), and the lower amount is offset by payments from a non-ATEO or an unrelated ATEO, this may indicate that the parachute payments were structured in a manner primarily to avoid liability under section 4960.

(5) Election to prepay tax. An ATEO may prepay the excise tax under paragraph (a)(1) of this section on any excess parachute payment for the taxable year of the separation from employment or any later taxable year before the taxable year in which the parachute payment is actually or constructively paid. 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 §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 in 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 the regulations in part 1 under section 1274) 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 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.

(6) Liability after a redetermination of total parachute payments. If an ATEO determines that an estimate made under §53.4960-3(j)(1) was incorrect, it must reapply the 3-times-base-amount test to reflect the actual time and amount of the payment. In reapplying the 3-times-base-amount test (and, if necessary, reallocating the base amount), the ATEO must determine the correct base amount allocable to any parachute payment paid in the taxable year. See §1.280G-1, Q/A–33(d) for examples that may be applied by analogy to illustrate the rules of this paragraph (d)(6).

(7) Examples. The following examples illustrate the rules of this paragraph (d). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO, any entity referred to as “CORP” is not an ATEO, and all employees are HCEs of their respective employers.

(i) Example 1 (Excess parachute payment paid by a non-ATEO)--(A) Facts. ATEO 1 and CORP 1 are related organizations that are treated as the same employer for purposes of §53.4960-3(e)(3) (defining separation from employment) and are both calendar year taxpayers. For 2021 through 2025, ATEO 1 and CORP 1 each pay Employee A \$250,000 of compensation per year for services performed as an employee of each organization (\$500,000 total per year). In 2026, ATEO 1 and CORP 1 each pay Employee A a \$1 million payment (\$2 million total) that is contingent on Employee A’s separation from employment with both ATEO 1 and CORP 1, all of which is remuneration, and no other compensation. Employee A is a covered employee of ATEO 1 in 2026.

(B) Conclusion. Employee A’s base amount in 2026 is \$500,000 (Employee A’s average annual compensation from both ATEO 1 and CORP 1 for the previous five years). ATEO 1 makes a parachute payment of \$2 million in 2026, the amount paid by

both ATEO 1 and CORP 1 that is contingent on Employee A's separation from employment with ATEO 1 and all organizations that are treated as the same employer under §53.4960-3(e)(3). Employee A's \$2 million payment exceeds 3-times the base amount (\$1.5 million). ATEO 1 makes a \$1.5 million excess parachute payment (the amount by which \$2 million exceeds the \$500,000 base amount). However, ATEO 1 is liable for tax only on the excess parachute payment paid by ATEO 1 (\$1 million parachute payment - \$250,000 base amount = \$750,000) that is subject to tax under §53.4960-4(a). CORP 1 is not liable for tax under §53.4960-4(a) in 2026.

(ii) Example 2 (Election to prepay tax on excess parachute payments and effect on excess remuneration)--(A) Facts. Employee B is a covered employee of ATEO 2 with a base amount of \$200,000 who is entitled to receive two parachute payments from ATEO 2, 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. ATEO 2 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 §53.4960-3(i), 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.

(B) Conclusion. The excess parachute payment is thus \$800,000 (\$200,000 plus \$800,000 present value of the \$900,000 future payment, less \$200,000 base amount), with \$40,000 of the base amount allocable to the \$200,000 payment and \$160,000 of the base amount allocable to the \$900,000 payment. 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 ($\$160,000 \times 21$ 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 section 4960(a)(1), 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).

§53.4960-5 Applicability date.

(a) General applicability date. Sections 53.4960-0 through 53.4950-4 apply to taxable years beginning after December 31 of the [calendar year in which the Treasury decision adopting these rules as final regulations is published in the **Federal Register**.]

Sunita Lough

Deputy Commissioner for Services and Enforcement.

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