

## IRS Issues Proposed Regulations for Tax on Nonprofit Executive Compensation

The Internal Revenue Service has issued proposed regulations describing the rules regarding the 21 percent excise tax on compensation over \$1 million and excess parachute payments paid by tax-exempt organizations to certain covered employees. The proposed regulations affect certain tax-exempt organizations, government entities, and certain entities that are treated as related to those organizations.

Section 4960 of the Internal Revenue Code (the Code), which was added to the Code as part of the Tax Cuts and Jobs Act of 2017, generally provides that an applicable tax-exempt organization is subject to a 21 percent excise tax for payment of compensation to a covered employee that is above \$1 million during a taxable year or that is based on the employee's separation from service and in excess of three times the employee's average annual compensation over the past five years (or if lesser, the number of years of service the employee has with the organization). The provision defines a covered employee as any employee or former employee who is or was one of the five highest-compensated employees of the organization for any taxable year beginning after December 31, 2016 (a covered employee). The excise tax applies to employers and is not imposed on covered employees.

Prior IRS guidance could have been interpreted to subject a for-profit business to the excise tax if a highly paid employee volunteered at a related tax-exempt organization. The proposed regulations create a welcome exception to the definition of a covered employee for employees whose total hours of service for the tax-exempt organization consist of less than 10 percent of their total working hours. Another new exception applies for employees that receive no compensation from the tax-exempt organization and who work more than 50 percent of his or her total working hours for another for-profit business.

The proposed regulations continue to exempt all compensation that is paid to a licensed medical professional that is for the performance of medical services, but continues to apply the excise tax to hospital and medical practitioners that are performing teaching, research, or other administrative tasks that are not directly related to the performance of medical services. Compensation paid for medical services is not taken into account for purposes of determining covered employees.

The regulations will take effect for taxable years beginning on or after the date the final regulations are published. However, aside from the exclusion of for-profit executives who volunteer at related tax-exempt organizations, there are not significant changes from the guidance previously issued in IRS Notice 2019-09, under which employers are currently obligated to comply with under a good-faith standard. The proposed regulations, however, allows employers to choose to immediately comply with the proposed regulations.



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