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VIA REGULATIONS.GOV

Hon. David J. Kautter
Asst. Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Mr. Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Re: Notice 2019-09 and Section 4960

Dear Messrs. Kautter and Desmond:

We are pleased to offer comments regarding the application of the excise tax under Section 4960, as added by Public Law 115-97 (the "Tax Cuts and Jobs Act" or "TCJA"). We write on behalf of corporate clients who have established and maintain charitable foundations and VEBAs. Typically, company executives serve as officers of these foundations and VEBAs, receiving little or no pay from them while performing occasional services on their behalf. Sometimes, company employees volunteer with these foundations by, for example, providing disaster relief services or aiding other charitable efforts funded by the foundation.

Congress did not intend to tax corporations under Section 4960 merely because their employees also provide unpaid services to a related charitable foundation or VEBA. These situations offer no risk to the fisc, because tax-subsidized foundation assets are not being diverted to pay these employees, and they are receiving no additional pay for their services to the foundations. We note Congress's stated policy concern in enacting Section 4960:

> [T]ax-exempt organizations enjoy a tax subsidy from the Federal government because contributions to such organizations are generally deductible and such organizations are generally 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.[1]

We are concerned that portions of the Service's initial guidance are incompatible with that intent and with the language of the statute. We respectfully offer the Service the below comments and recommendations of specific concern to our clients.

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[1] House Rep. 115-409, 333 (Nov. 13, 2017).

1. **The Service should interpret Section 4960(a) consistent with its intent, by capping the tax's application to amounts paid by the ATEO.**

In enacting Section 4960, Congress intended to tax excessive pay that is tax-subsidized because its payor is a tax-exempt entity. The statutory design recognizes that even $1 paid by an applicable tax-exempt organization (an "ATEO") could be "excessive" – if the covered employee is also paid a sufficiently large sum from a related organization. *See* Section 4960(c)(4)(A) (defining remuneration paid by an ATEO to include remuneration paid with respect to employment by a related organization). For these situations, Congress included an allocation rule – Section 4960(c)(4)(C) – to impose responsibility for the tax on the related organization in proportion to its share of the overall pay to the covered employee. For example, if an ATEO pays a covered employee $2,000 and a related taxable entity pays her $1,998,000, the ATEO is responsible for a negligible portion of the overall tax (2,000 / 2,000,000, or 0.1%).

The allocation rule does not identify the overall amount that is taxed; it simply decides which entity is responsible for which portion of the tax. Continuing the example above, should the tax apply to $1,000,000 – the full amount exceeding Section 4960(a)(1)'s $1,000,000 threshold – or $2,000 – the amount tax-subsidized and diverted from the ATEO's resources? As a matter of the stated policy motivating Section 4960, the answer is clear: the tax should apply only to amounts paid from the ATEO; amounts paid from related organizations are not tax-subsidized and do not divert resources from the ATEO.

In Notice 2019-09, the Service adopts the broader approach and concludes that the tax applies to the full $1,000,000 in the example above. *See* Notice 2019-09, Q&A-11 (the amount taxed is the total amount of remuneration paid by the ATEO or a related organization, minus $1,000,000). The policy motivating this result is not apparent.

The better reading of Section 4960 also weighs against the Service's interpretation:

- The amount taxed is determined under Section 4960(a)(1), which states that the tax applies to "so much of the remuneration paid . . . by an [ATEO] for the taxable year with respect to employment of any covered employee in excess of $1,000,000."

- The Service does not identify how, if at all, it interprets the language limiting the tax to amounts paid "with respect to employment of any covered employee."

- The most reasonable interpretation of this language is that the tax applies only to amounts paid for employment *with the ATEO*, rather than to amounts paid for employment with any related – or unrelated – organization(s). This is the more reasonable interpretation in light of the policy motivating Section 4960 but also because of the plain language: in particular, the language refers to "employment of a covered employee" and the term "covered employee" is defined specifically with regard to an ATEO. Related organizations do not have covered employees.

In other words, related organization pay might count for determining whether there is excess over the $1,000,000 threshold, and for what share of any tax each entity bears responsibility. But, assuming there is excess over the $1,000,000 threshold, the actual

amount of tax should be determined based only on amounts paid for employment with the ATEO (which, generally speaking, are the amounts paid directly by the ATEO).[2]

If the Service were to interpret Section 4960(a)(1) consistent with Congressional intent, it should resolve the majority of concerns companies with related foundations and VEBAs have about the proposed reach of Section 4960. In addition, some of our other recommendations may become less necessary – which should make it easier for the Service to write rules that achieve Section 4960's purpose and prevent circumvention of the rules.

2. **The Service should clarify that ATEO officer status is not presumptive of employee status.**

Notice 2019-09 provides mixed signals regarding the definition of "employee" under Section 4960. It states that "only an ATEO's common law employees (including officers)" can become covered employees. This could be read to imply that officers are common law employees. This is not accurate as a matter of fact or under the Internal Revenue Code. To the contrary:

- There is nothing in the Service's test for common law employment that automatically prevents an officer from being an independent contractor.

- Elsewhere in the Code, when Congress intended to include "officers" as "employees," it has done so explicitly. *See* Sections 3401(c) & 3121(d) (defining employee to include "officer"); *see also* Treas. Reg. Sections 31.3401(c)-1(f) & 31.3121(d)-1(b) (further defining employee to exclude officers who perform minor services and receive no remuneration).

Section 4960 does not define "employee." The Service should not import an overly broad definition that Congress did not adopt. Instead, the Service should conclude that "covered employees" under Section 4960 must be common law employees and that "officer" status is not presumptive of common law employee status. If the Service instead concludes that statutory employees are employees under Section 4960, then the Service should confirm that a minor services exception applies to ATEOs such as company foundations where officers typically have very limited involvement.

3. **A volunteer safe harbor should be available for related organization employees who are paid no additional compensation for service with an ATEO.**

When employees of a related organization volunteer with an ATEO, there is no concern that resources are being diverted from the ATEO to pay excessive compensation. In the context of company foundations, there are two common types of volunteers:

[2] We understand that the Service may need to adopt rules to address situations in which there is a disparity between what an ATEO directly pays and what a covered employee is paid for services provided to the ATEO by applying common law agency principles.

- First, a company employee may volunteer to serve as an officer of, or in another leadership role with, the ATEO. As explained above, an officer should not be presumed to be a common law employee covered by Section 4960.

- Second, employees may volunteer for the company foundation just as they do for unaffiliated charitable organizations, sometimes as part of a company volunteering day.

In either case, the Service's guidance raises concerns that the ATEO could exercise sufficient control over the volunteer's efforts that the volunteer could be considered its common law employee. For most purposes, this would have no practical tax consequence. However, as initially interpreted by the Service, Section 4960 could impose taxation on amounts the company pays these employees for non-ATEO services.

We recommend that the Service propose clear and reasonable safe harbors to exempt this sort of volunteering from Section 4960. The safe harbors should accommodate the fact that ATEOs vary significantly in their practices and have differing methods and abilities for tracking volunteering efforts. For example, safe harbors could be made available on the basis of unpaid services up to a fixed number of days per year (e.g., 30 days) or hours per year (e.g., 250 hours).

As a more fundamental matter, the Service should consider exempting from taxation any employees not paid from the ATEO. We understand that the Service may be concerned that ATEOs will coordinate with related organizations to structure pay to "circumvent" Section 4960. In this regard, we recommend that the Service be mindful of the purpose of Section 4960: preventing the diversion of resources from an ATEO in order to pay excessive compensation. A company encouraging volunteering (even paying employees to incentivize their support of the foundation) is doing precisely the opposite: it is mobilizing its workforce to *aid* the efforts of the ATEO, not divert resources from it. The Service should view this type of arrangement as exactly what Section 4960 was designed to encourage, not something that the Service needs to prevent. Of course, the Service could still write rules to prevent and disallow actual tax avoidance that diverts assets from the ATEO – e.g., an ATEO paying a "fee" to a related organization for services and the related organization in turn hiring employees to provide services to the ATEO.

4. **ATEOs should have flexibility to define their five highest compensated employees and specifically be permitted to exclude those employees without a threshold level of pay from the ATEO.**

Section 4960 does not prescribe a specific method to determine which of an ATEO's employees are the five "highest compensated." Notice 2019-09 proposes in Q&A-12 using "remuneration" from all related organizations for this purpose. The given rationale is that remuneration is a "fair representation" of compensation earned by the employee and is more "administrable" because remuneration is the same standard for calculating the tax imposed by Section 4960.

This rule, by which "compensation" is equated with "remuneration," is neither required nor supported by the statute. In fact, the statute supports the opposite interpretation:

- Section 4960(c)(3) specifically defines the term "remuneration." The term appears 16 times in Section 4960. But Section 4960(c)(2) uses a different term—"highest compensated"—to determine covered employee status. The choice of different terms suggests that they are not interchangeable.

- Even if "remuneration" is a "fair representation" of compensation, the statutory text does not provide that remuneration includes remuneration from related organizations for this purpose. The related organization rules of Section 4960(c)(4) provide only that "remuneration *of a covered employee*" (emphasis added) includes remuneration from a related organization. Thus, one must first assess whether an employee is a covered employee, and only then take into account remuneration paid by related persons. The related organization payment rules do not apply to the threshold question of whether an employee is a "covered employee."

We appreciate the Service's effort to seek an administrable standard for determining covered employee status. ATEOs come in all shapes and sizes. Accordingly, the Service should set forth more than one permissible method for determining an ATEO's five highest compensated employees. Such permissible methods should include at least one method that incorporates only pay to the employee from the ATEO or with respect to services performed for the ATEO, applying common law agency principles.[3] At the very least, such a method should be available with respect to employees who provide a minimal level of their overall services to the ATEO.

Finally, given the Service's intent to seek an administrable standard, as well as the policy considerations behind Section 4960, we recommend that the Service exclude from the definition of "highest compensated employees" individuals who receive no additional pay for their work with an ATEO or who are paid less than a certain threshold (we suggest $50,000 as a reasonable annual figure).

Consider an ATEO with no other paid employees that hires three college students for $15 per hour to judge a high school debate tournament. Alternately, consider the case in which three college students paid $15 per hour for a summer job at a company affiliated with a newly-formed ATEO also volunteer with the ATEO to run a high school debate tournament. Without an exclusion rule, the ATEO and related company would be required to track those students as "covered employees" for all future years. This is a phenomenally burdensome and wasteful requirement. It is a trap for the unwary, serving no apparent policy purpose.

5. Entities should be related to an ATEO only if there is an actual control relationship between them, not just a common link through employment.

Section 4960(c)(4)(B) identifies a person or government entity as related to an ATEO if such person or government entity "controls, or is controlled by" the ATEO, or "is controlled by one or more persons which control" the ATEO. Q&A-8 states that a person controls a nonstock ATEO if the person or its "representative" appoints the majority of the

[3] We recognize the Service may need to include safeguards to avoid abuse, such as limiting the ATEO's ability to change methods from year-to-year, or to have all related ATEOs use the same method.

ATEO's Board members, and it defines "representative" to mean "a trustee, director, agent, or employee" of the person.

It appears that Q&A-8 offers a broader definition of "control" than the Service intended. Notice 2019-09 elsewhere states that the Service would use the existing definition of "control" under Section 512(b)(13)(D). However, Q&A-8 introduces a definition of control that is broader than that under Section 512(b)(13)(D). In the Instructions to the Form 990, the Service opined that "control" may be exercised directly by a "parent" organization or indirectly through the parent's "officers, directors, trustees or agents, *acting in their capacity as officers, directors, trustees, or agents*" (Instructions for Form 990, definition of "Control") (emphasis added). Q&A-8 lacks this crucial requirement that someone act in their capacity as an officer, director, trustee or agent to be a representative.

Even if the Service intends to deviate from the Section 512(b)(13)(D) definition of "control," Q&A-8's standard is unreasonably broad. It would cover employers with the mere capacity to influence an ATEO and, in many cases, employers with no capacity to influence or control an ATEO. Employers are often unaware of the activities of their employees outside the scope of their employment. To comply with Q&A-8, employers would need to monitor employees' personal activities. In fact, certain union activity is protected by federal law, and some state laws prevent employers from limiting their employees' political or charitable activities or other affiliations. Certain state laws also prohibit employers from even keeping a record of this information. The Service should not interpret Section 4960 in a way that raises any issues under these laws.

Company foundations are designed to be controlled by and carry out the tax-exempt operations of the affiliated taxable company. The Notice 2019-09, Q&A-8 definition could sweep in organizations that a company has no control over and even no knowledge of. This would ensnare exempt organizations established and run by two or more employees before they were employees, or controlled by a single employee or director and her spouse (a result of the imported Section 318 attribution rules).

Fortunately, a simple solution exists: the Service should respect corporate formalities and adopt the standard that appears to apply under Form 990. If authority to act or appoint is conferred upon an individual in their personal capacity, not in their capacity as a trustee, director, agent or employee of another person, then the individual should be presumed not to be acting as a representative of any other person.

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Thank you for the opportunity to share our comments. We welcome an occasion to discuss these issues further.

Respectfully submitted,

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Ivins, Phillips & Barker, Chartered