

Nonprofit Excess Compensation: Final Regulations

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The clock was ticking.

The [final regulations](#) for IRC [section 4960](#), the excise tax on the “excess compensation” of nonprofit executives, made it into the Federal Register in the nick of time on January 19, 2021 – just hours before Inauguration Day.

This was the official conclusion of rule-making for the last of the controversial statutes directly affecting tax-exempt organizations that had been tossed into the rushed and sloppy mix of the Tax Cuts and Jobs Act of 2017 (TCJA ‘17).

So that’s that, right? All done?

Not so fast. There’s a new sheriff in town: See [Regulatory Freeze Pending Review](#) (January 20, 2021), The White House.

Rule-making Freeze

This freeze affects all rule-making – regulatory *and* subregulatory – in progress at noon on Inauguration Day across the entire federal government. In addition, for all final items officially published in the Federal Register within the sixty days before January 20th, there is a hold for at least thirty days and perhaps longer.

What’s included in the temporary hold are both the freshly minted section 4960 excess compensation regulations discussed in this post as well as the deeply unpopular new “silo” rules for calculating the unrelated business income tax (UBIT) under new section 512(a)(6). See our last post: [Final UBIT Rules Issued](#) (January 27, 2021).

The final regulations on the new excise tax on net investment income, section 4968, escaped *this particular* scrutiny, having been published in September 2020 before the 60-day window.

Tax Laws Affecting Nonprofits

It's no wonder that it took three long years for federal officials in the Treasury and the IRS to get through the tortuous process of producing these final regulations.

We've taken every opportunity since December 2017 to relate the sorry details about how the former Administration and the GOP leadership of that Congress "rushed through their pet legislative project": the massive Tax Cuts and Jobs Act (TCJA '17). They "tossed aside many of the customary procedures – helpful items like committee hearings, multiple revisions of draft bills, and meaningful bipartisan debate." It was – simply put – a 500+-page mess that few lawmakers read before voting on it. To make matters worse, the customary transition periods were also left out; the new laws took effect immediately on January 1, 2018.

All along, the nation's nonprofits, academics, professional advisors, and leading sector organizations have voiced dismay about the four new statutory provisions in the TCJA '17 directly affecting tax-exempt organizations.

Thankfully, one of the four statutes was so odious that Congress gave it a quiet and ignominious burial in the December 2019 darkness . See [Poof! The Nonprofit Parking Tax is Gone](#) (January 7, 2020).

Nonprofit Excess Compensation

Neither this excess-compensation tax nor the new UBIT silo statute made it quickly or easily even to the (usual) first step in the rule-making process; that is, the drafting and posting of proposed regulations for public comment. In both cases, federal officials first issued "interim guidance" documents to help the nonprofit sector with what everyone, including the government, acknowledged was confusion and uncertainty.

For this section 4960 excise tax on excess nonprofit compensation, this preliminary written guidance was [Notice 2019-09](#). Dated December 31, 2018, it came a full year after the new law went into effect. As [one legal commentator explained](#), there was good news and bad news for the nonprofit community in that document. "First the 'good' news: the IRS addressed many questions left open by the rather vague statutory provisions. Now the 'bad' news: the IRS narrowly construed many of the statutory provisions, which ultimately will result in additional administrative burden and cost to tax-exempt organizations subject to the rules...." The public comment period yielded fourteen responses from nonprofits and their advisors.

It was almost eighteen months until the Treasury/IRS officials followed up the late December 2018 advice with proposed regulations posted on June 11, 2020. The 177-pages-long document reasserts that "interim guidance" with some adjustments." Most particularly, the proposed regulations address a key concern raised in the first round of public comments; that is, whether the excise tax should apply to the (otherwise highly compensated) "volunteers" that for-profit businesses supply to

affiliated nonprofits.

Final Regulations

The January 19, 2021, final regulations under Internal Revenue Service section 4960 follow the welcome pattern of our federal tax officials; that is, they discuss the specific points raised by the public during the 60-day comment period, noting any adjustments made based on those suggestions and questions.

Generally, these section 4960 final regulations adopt much of what was in the proposed regulations. Where possible, though, the earlier definitions and other matters have been further refined. This process is explained point-by-point.

There is helpful commentary from the legal and accounting community; see, instance: *Final section 4960 regulations on excise tax for excess remuneration and excess parachute payment* (January 13, 2021) KPMG (based on unofficial draft of final regs); and *Final rules on exempt organization excess remuneration* (January 12, 2021) Sally P. Schreiber, J.D., *The Tax Advisor*

Conclusion

The Biden Administration's regulatory-pipeline freeze and the temporary hold on just-issued final rule making is a harbinger of what is to come. There will be a broad-based reevaluation of laws (and policies) across the entire federal government.

This "second-look" will touch on areas of interest for many nonprofits well beyond just tax issues. It will include critical topics like immigration, the environment, labor law, and income inequality – to name only a few.

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