S CORP

Defending America's Small & Family Owned Businesses

May 29, 2019

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of Treasury
1500 Pennsylvania Avenue, NW
Washington DC 20220

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

Re: Notice 2019-09 and Section 4960

Dear Messrs. Kautter and Desmond:

The S Corporation Association is seriously concerned that the new excise tax under Section 4960, as applied in Notice 2019-09, could impose significant new taxes on private operating businesses where the owners and officers of those companies contribute time and money to a non-profit. That was not the intent of Congress, and we respectfully request that future guidance or rules issued on Section 4960 narrow the definitions of "employee" and "related" organization to minimize the number of private companies that may be inadvertently taxed under this new Section.

How does a tax targeted at tax-exempt organizations hit private operating companies instead? A typical case is where a successful family business or family stakeholders establish a private foundation ("Foundation"), where the family business and/or family stakeholders or non-family employees of the business contribute financial support to the Foundation and personal time administering the Foundation's affairs as unpaid directors, officers or staff. The compensation paid by private operating companies is not impacted by the personal services provided by these employees to the Foundation. Under the broad definition of "employee" included in Notice 2019-09, officers of the Foundation could be considered employees of the Foundation even though they receive no compensation from the Foundation, are full-time employees of the company and provide limited services to the Foundation or otherwise serve the Foundation in a nominal capacity.

The Notice may also be applied in a manner that a "related person or government entity" could include private operating companies merely because the Foundation is financially dependent on contributions from the company and has overlapping directors, officers and staff. The result is that highly-compensated employees of the company could be included in the Foundation's "top five" compensated individuals for purposes of the $1 million threshold.

The excise tax is pro-rated to the entity paying the compensation, so in the case posited above where the Foundation pays no compensation, the company could owe an excise tax of 21 percent on compensation exceeding $1 million, even though the relevant "employees" donated limited personal services to the Foundation.

Finally, private operating companies subject to this unintended excise tax cannot terminate their ongoing liability by having the relevant family stakeholders or other business employees end their relationship with the Foundation, as Section 4960 makes clear that once an individual is listed as a "covered employee" of an Applicable Tax Exempt Organization (ATEO), they are always to be listed, even if the individual is no longer associated with the ATEO. These relevant family stakeholders or other employees of the company could stop volunteering at the Foundation, but their compensation in excess of $1 million from the company would continue to be subject to the 21-percent tax. ***The only practical means to end the tax may be for the Foundation to transfer its assets to a Donor Advised Fund.***

This outcome was also obviously not the intent of Congress when it enacted Section 4960. As made clear in the House Report 115-409, the target of the tax was tax-exempt organizations with highly compensated employees:

> [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…. As a result, such organizations are subject to the requirement that they use their resources for specific purposes, and the Committee believe that excessive compensation (including excessive severance packages) paid to senior executives of such organizations diverts resources from those particular purposes.

The purpose of including related entities when identifying a "covered employee" and calculating the tax is to prevent a tax-exempt organization from avoiding the excise tax by shifting the compensation of highly-paid individuals from the non-profit to one or more related non-profit or for-profit entities (e.g., by shifting the compensation of a non-profit hospital's CEO to multiple non-profit organizations, or to a single for-profit entity controlled by the hospital). This concern is consistent with the notion that non-profit organizations should spend their resources on charitable activities, not on out-sized compensation packages.

This later example suggests that Congress intended to include for-profit companies in the calculation of the tax, but *only* when they are used to conceal or disperse compensation otherwise attributable to the ATEO. Under this dynamic, the ATEO controls the for-profit company for purposes of compensating relevant employees, not the other way around. Only when the ATEO is funding the employment of highly-compensated individuals are charitable resources arguably being diverted for non-charitable purposes.

While the mandate that "covered employees" always remain listed is part of the statute, the rules governing who is an "employee" of an ATEO and which organizations are considered "related" to the

ATEO are not. We believe Treasury has wide discretion in these areas and, consistent with the intent of Congress to ensure that charitable resources are used for charitable purposes, should exercise that discretion to minimize the impact Section 4960 has on private operating companies and Foundations.

Specifically, we propose:

1. Treasury should refine the definition of "employee" to exclude volunteers. As described above, a significant number of families operate successful businesses and form, directly or through the company, non-profit organizations where the company and stakeholders and/or employees of the business donate both their time and money. While these volunteers may sometimes have a formal officer title with the ATEO, typically they do not receive compensation for their efforts and are volunteers by any definition. Excluding volunteers from the definition of "employee" is an easy step that would address a significant number of cases where private companies may otherwise be inadvertently taxed under Section 4960.

2. Treasury should refine the definition of "employee" to preclude its application to non-profit officers who provide minimal services and receive no or minimal compensation from the non-profit. Notice 2019-09 states that "only an ATEO's common law employees (including officers)" can be covered employees. The insertion of "officers" here could be interpreted to mean that all ATEO officers are considered "employees" for purposes of identifying the ATEO's "covered employees," but that is not consistent with the statute or employment law. As Section 4960 does not define "employee," Treasury has discretion on how broadly to define the term. Our recommendation is to define the term narrowly to include only those individuals who provide services to the ATEO above a de minimis threshold, such as 100 to 200 hours annually or 2 to 4 hours per week (i.e., 5 to 10 percent of equivalent full-time work).

3. Treasury should narrow the definition of "related" organizations to limit the number of for-profit companies potentially subject to the tax. While Section 4960 identifies a "related" organization as one that controls, or is controlled by, the ATEO or is controlled by one or more persons that control the ATEO, the statute does not define what constitutes "control" in the context of our expressed concern. Merely because a for-profit business is a primary financial sponsor of an ATEO, has overlapping directors and officers with an ATEO, or whose employees provide limited personal services to the ATEO, such factors alone should not be determinative of "control" by a for-profit business and relatedness to an ATEO for purposes of applying the excise tax. Rather, "control" and relatedness should be evaluated and determined in the context of circumstances and criteria which demonstrate a joint-operational relationship between the for-profit business and the ATEO facilitating direct or indirect compensation of relevant key employees attributable to services provided to or on-behalf of the ATEO – thereby diverting resources that would otherwise be available to the ATEO for charitable purposes.

S CORP

Defending America's Small & Family Owned Businesses

4. Finally, Treasury should support legislation to repeal the mandate that "covered employees" are always listed as such. While this rule is imposed by statute, it's unclear whether Congress fully understood its implications when it was adopted. As enacted, the new requirement will force ATEOs to endlessly track employees, regardless of whether they provide ongoing services to the non-profit, and will prove to be a trap for the unwary. The statute's retroactive application of the "covered employee" test to taxable years beginning after December 31, 2016 will only serve to make the trap worse.

In closing, the typical relationship between private operating companies and private foundations is not abusive - sufficient safeguards already exist to regulate appropriate interaction between these entities and their stakeholders, such as self-dealing rules -- and is not the target of Section 4960. The potentially broad sweep of IRS Notice 2019-09 to include private operating companies and private foundations will potentially end the use of private foundations by these companies and their stakeholders in favor of Donor Advised Funds. Obviously, that is not the intent of Section 4960, but it will likely be the ultimate result.

The S Corporation Association appreciates the opportunity to comment on the IRS's preliminary guidance and anticipated proposed regulations under Section 4960 and welcomes additional communication on this important issue.

Sincerely,

Brian Reardon
President
S Corporation Association