

PSW PROFESSIONAL LEARNING WEBINAR



DATE/TIME

TUESDAY, JUNE 16 10 AM CT

PRESENTED BY



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Logistics

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Background on Tax Guidance

Background on Tax Guidance

- The Internal Revenue Code is the foundation of the US federal tax system
- The Code does not answer all the tax questions that arise and often the statute does not provide enough detail for taxpayers to have certainty for their tax obligations
- In section 7805 of the Code, Congress has given general authority to the Secretary of the Treasury and his delegates to "prescribe all needful rules and regulations for the enforcement of [the tax laws]"
- Code sections may also give authority to issue regulations in particular areas

More Background on Tax Guidance

- The preparation and issuance of guidance and regulations is a joint effort of the Treasury Department's Office of Tax Policy and the Internal Revenue Service
- Participants in the process generally include lawyers (and sometimes economists) in the Office of Tax Policy and lawyers in the IRS Office of Chief Counsel
- The development and drafting of regulations is a lengthy process involving numerous internal memoranda, drafts, meetings, and briefings
- In preparing regulations, the drafters take into account the words of the statute, Congressional intent, potential burden on taxpayers, and ease of administrability by the IRS

More Background on Tax Guidance

- Priority Guidance Plan is an annual plan (July 1 June 30) which provides a list of priority guidance projects for Treasury and the IRS
- Each year a Notice is issued requesting submissions for the annual plan. Notice 2020-47 was released June 10, 2020 and submissions are due July 22.
- Current priority is guidance under Tax Cuts and Jobs Act, but Treasury and the IRS are still working on other projects

More Background on Tax Guidance

- Some current projects on the Priority Guidance Plan affecting tax-exempt organizations
 - Guidance revising Rev. Proc. 80-27 regarding group exemption letters (Notice 2020-36)
 - Guidance on circumstances under which an LLC can qualify for recognition under §501(c)(3)
 - Final regulations on §509(a)(3) supporting organizations
 - Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners
 - Regulations regarding the excise taxes on donor advised funds and fund management

Regulations Comment Process

- Guidance can be provided as sub-regulatory guidance (Notices, Revenue Rulings, Revenue Procedures), or regulations
- Regulations are first issued in proposed form
- Some regulations are issued simultaneously as both proposed and temporary (i.e., immediately effective) in order to provide presently needed guidance or to prevent abuse
- After issuance of proposed regulations, a notice, and comment period follows
- The comment period is normally 60 or 90 days
- If requested, a public hearing is held

Government Review of Comments

- The Office of Tax Policy and the IRS review comments
- Written comments are important. They are far more effective than oral comments
- The preamble to final regulations describes the written comments and responds to them
- The government might accept comments in whole or in part, with revised rules in the final regulations
- If the government reject the comments, they will provide an explanation in the preamble
- In some cases, if the government decides on its own or in response to comments that the proposed regulations need to be significantly changed and the opportunity for additional comments is appropriate, the regulations might be re-proposed

Preparation of Comments

- In preparing comments, it is important to provide a clear description of your concerns
- It might be useful to explain your organization to help the government understand the realworld impact of the regulations
- Do not merely state problems. Offer a solution.
- In devising a solution, take into account possible limitations on the government's ability to adopt the solution, such as constraints caused by the wording of the statute, the scope of regulatory authority, or broader tax policy considerations
- Provide a thorough and thoughtful solution that considers collateral issues raised by the proposed solution. References to analogous situations with similar solutions are helpful.
- Practical solutions that reduce taxpayer burden and ease IRS administrability are preferable
- Express support for rules you favor that are in the proposed regulations (because other commenters might be taking a position contrary to yours regarding those rules)





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Notice

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Section 4960: Tax on tax-exempt executive compensation



Section 4960

- Section 4960 imposes an excise tax equal to the corporate tax rate (21%) on:
 - Remuneration in Excess of \$1 million per tax year
 - Paid by an *applicable tax-exempt organization* (or *related organizations*) with respect to employment of a *covered employee*; and
 - "Excess" Parachute Payments
 - Paid by an applicable tax-exempt organization (or related organizations) to a covered employee (similar to 280G)
- Effective for taxable years of the employer beginning after December 31, 2017.



Section 4960 Roadmap

Identify the relevant parties.

- -Who are the ATEOs?
 - -Who are non-ATEO related orgs?
 - -Who are the covered employees?

Identify all remuneration paid.

-What entities paid the employee?

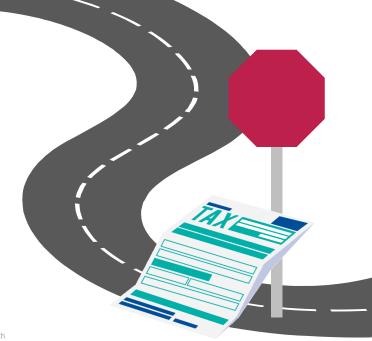
-Any reductions (e.g., 162(m))?

-Is total over \$1m?

Identify any

involuntary separations.

- -Are there any parachute payments?
- -What is each covered employee's base amount?
- -Are there excess parachute payments?





Section 4960: Proposed regulations

- Treasury and IRS released proposed regulations under section 4960 on June 5, 2020
 - Guidance provided in these proposed regulations generally is consistent with the guidance provided in Notice 2019-09, released on Dec. 31, 2018
- Final regulations are proposed to apply to taxable years beginning on or after the date the final regulations are published in the Federal Register
- Until the final regulations apply, taxpayers may rely on the guidance provided in the proposed regulations or Notice 2019-09, including for periods prior to June 5, 2020
- Taxpayers may also base their positions upon a reasonable, good faith interpretation of the statute
 - Notice 2019-09 and the preamble to the proposed regulations list certain positions that Treasury and the IRS believe are not a reasonable, good faith interpretation of the statute



What is an ATEO?

- An applicable tax-exempt organization ("ATEO") includes:
 - Organizations exempt from tax under section 501(a);
 - Exempt farmers' cooperatives (section 521(b)(1));
 - Political organizations (section 527(e)(1)); and
 - Organizations that have income excluded from gross income under section 115(1).
- ATEO does not include:
 - Some state universities; and
 - Some state and local governments.



Who are Related Organizations?

 Section 4960 applies not just to ATEOs, but also to entities that are related to an ATEO

— A person or governmental entity is related to an ATEO if the person or governmental entity <u>controls</u>, or <u>is controlled by</u>, the ATEO or <u>is controlled by one</u> <u>or more persons that control</u> the ATEO.



Who are Covered Employees?

5 highest compensated employees of the ATEO for tax year (including compensation from related orgs)











or

Was a covered employee of the ATEO (or any predecessor) for any tax year beginning after December 31, 2016



Once a covered employee, always a covered employee



Who are employees?

- No definition of "employee" in the statute
- Proposed regulations define an "employee" using same multifactor definition as in Section 3401, which includes common law employees and any officer of a corporation
 - Note that under the proposed regulations, "volunteers" may be considered employees
 - Board members are independent contractors, not employees
- "Minor services" exception: 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



Who are covered employees?

- Top 5 highest compensated employees of the ATEO
 - "Compensation" defined in regulations as remuneration
 - Compensation includes compensation from related organizations
- Employee is <u>not</u> one of an ATEO's 5 highest-compensated if the ATEO paid less than 10% of the employee's total remuneration (unless that ATEO paid the most remuneration).
 - So one employee doesn't take up a top-five "spot" for multiple ATEOs
- Concern for company foundations: Highly compensated employees of a company who volunteer as officers of the company foundation could be "covered employees" of the foundation



Covered employee: proposed exceptions

- The proposed regulations provide that an individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if the requirements for one of two exceptions are met:
 - The limited hours exception
 - The nonexempt funds exception
- Both exceptions require that neither the ATEO nor any related ATEO have 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
 - For this purpose, remuneration paid to an individual by a related organization that is the individual's employer is not treated as paid by the ATEO if the related organization is not reimbursed by the ATEO or entitled to any other consideration from the ATEO



Limited hours exception

- To satisfy the limited hours exception, an individual must have performed services as an employee of the ATEO and all related ATEOs for no more than 10% of the total hours the individual worked as an employee of the ATEO and all related organizations during the applicable year
 - Safe harbor: An individual is treated as having performed services as an employee of the ATEO and all related ATEOs for no more than 10% 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



Nonexempt funds exception

For the nonexempt funds exception, the following requirements must be met:

- No 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
- 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
- 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)



Section 4960: "Excess" Remuneration

- 21% excise tax imposed on "so much of 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 \$1,000,000."
- Remuneration means wages (as defined in section 3401(a)), with some adjustments (relating to benefit plans) and:
 - Excludes remuneration paid to licensed medical professionals performing medical services (including veterinarians)
 - Does not include any remuneration for which the deduction is disallowed by reason of section 162(m).
 - Determined based on calendar year ending with or within the employer's tax year and treated as paid when there is no substantial risk of forfeiture
- Remuneration of a covered employee by an ATEO includes any remuneration paid with respect to employment of such employee by any related person or governmental entity.



Who is Liable for the Excise Tax?

- The common law employer (for federal tax purposes) is liable for the excise tax imposed under section 4960
 - Payment made by another entity for services rendered to the common law employer is treated as payment from the common law employer
 - Entity making payment and/or issuing Form W-2 not necessarily liable.
- When remuneration is paid by an ATEO and other related organizations
 - Each employer (including taxable entities) is liable for the excise tax proportionate to the relative amount of remuneration paid



UBIT "siloing" under §512(a)(6)

Section 512(a)(6)

- —Exempt organization with more than one unrelated trade or business must compute UBTI separately for each business
 - NOLs are determined with respect to each separate trade or business
 - NOLs generated for tax years beginning before January 1, 2018 are available to apply against aggregate UBTI
- —Effective for tax years of the exempt organization beginning after December 31, 2017







SILO₂



SILO 3

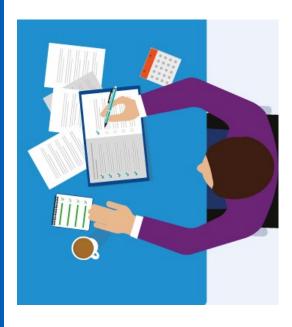


Notice 2018-67 (August 21, 2018)

- —Provided safe harbors
 - 6-digit NAICS codes for identifying separate trade or business
 - Partnership interests could be treated as one trade or business if they met a de minimis test or a control
 test
 - De minimis test: directly hold ≤ 2% capital and profits interest
 - Control test: No control and directly hold ≤ 20% capital interest
 - Interest in one partnership could be treated as one trade or business under a "transition rule"
 - Partnership interest acquired before August 21, 2018
- —Stated intent to propose regulations to permit aggregate reporting for "investment activities"



Proposed regulations under section 512(a)(6)



Section 512(a)(6) – Silo-ing

- —Proposed regulations released on April 23, 2020
- —Taxpayers may rely on them "in their entirety"
 - —May also rely on prior guidance (Notice 2018-67) or a reasonable, good faith interpretation of the statute
- —Largely follows prior guidance (Notice 2018-67), though more favorable in several respects



Proposed regulations under §512(a)(6)

Two-digit NAICS Codes

—Under the proposed regulations, business activities that are not investment activities or under one of the other exceptions would be classified pursuant to 2-digit NAICS codes. 20 Economic Sectors. See listing at:

Census.gov

—Once an exempt organization identifies a 2-digit NAICS code for the trade or business, it would not be able to change it unless the NAICS code originally identified was erroneous

Investment activities

- Under the proposed regulations, most tax-exempt organizations may treat the following "investment activities" as a single unrelated trade or business:
 - · Qualifying partnership interests (QPIs)
 - As in Notice 2018-67, QPIs are generally defined as partnership interests that meet the de minimis or the control test
 - If an organization designates a partnership interest as a QPI, it cannot subsequently identify trades or businesses of the partnership using the NAICS codes until and unless the QPI fails to qualify as such
 - · Qualifying S corporation interests
 - Defined the same as QPIs, except looking to stock ownership
 - Debt-financed property or properties (within the meaning of section 514)



Proposed regulations under section 512(a)(6)

- When determining whether QPIs are below the required percentage thresholds:
 - Do not need to take into account interests of directors, officers, or other "disqualified persons"
 - Only take into account interests of certain related entities for the control test
- Even if organization owns more than 20% capital interest in a top tier partnership it doesn't control, lower-tier partnership interests may be QPIs if de minimis test is met
- Minor modifications to definition of "control"
 - Notice 2018-67 looked to whether the exempt organization had "control or influence" over the partnership. The proposed regulations remove the reference to "influence"
 - The proposed regulations clarify that an organization has control over a partnership if the organization "by itself" (as opposed to with other partners)—
 - may require the partnership to perform or not perform any act that significantly affects the operations of the partnership; or
 - may appoint or remove a "majority" (as opposed to any) of the partnership's directors (or any of the partnership's officers or employees).



Net operating losses

CARES Act: Five-year carryback period for 2018, 2019, and 2020 NOLs

- Applies to NOLs arising in tax years beginning after 12/31/2017 and before 1/1/2021
 - —Can create rate benefit for carrybacks to 2013-2017 when higher corporate tax rates may have applied
 - —NOLs generated from separate/"siloed" trade/business activities may be carried back to "un-siloed" pre-2018 years and applied against aggregate UBTI
 - —See IRS FAQs on NOL carrybacks by exempt organizations at https://www.irs.gov/newsroom/faqs-carryback-of-nols-by-certain-exempt-organizations

Suspension of NOL limitation of 80% of taxable income for 2018-2020



COVID -19 Relief Provisions

Qualified disaster relief payments – IRC 139



- General requirements:
 - Must be reasonable and necessary expenses incurred as a result of a qualified disaster
 - Cannot be wage/income replacement
 - Cannot be reimbursed by insurance
- Non-taxable to the recipient, deductible by employer
- No tax-specific documentation requirements, but documentation of position is recommended
- Examples of potential qualified expenses:
 - Travel expenses incurred to prevent COVID-19 spread
 - Medical expenses related to COVID-19 (not covered by insurance)
 - Childcare/education expenses related to mandatory WHF/quarantine
 - Certain home office items as a result of WFH requirements
- Some expenses will be one-time; others may be ongoing



Paid leave provisions

Applies to:

- Private employer with fewer than 500 employees,
- Public agency, and
- (For EPSL only) any other entity that is not private

Note: Count number of employees on date of leave

Emergency Paid Sick Leave (EPSL)

- Employees eligible day one
- Up to 80 Hours (basically, first 10 days)
- Six Triggers
- Full or 2/3rd pay depending on trigger
 - Full pay, capped at \$511 daily and \$5,110 in aggregate, or
 - 2/3rd pay capped at \$200/day and \$2,000 in aggregate

Employers obligated to provide leave, but also receive corresponding credits EXCEPT NO credits are provided for government employers

Note: An employer may receive an advanced credit prior to the expense.

Emergency Paid FMLA (FMLA +)

- Employees eligible with 30 calendar days on payroll
- Up to 12 Weeks
 - First two weeks may be unpaid
- One trigger
- 2/3rd pay, capped at \$200/day and \$10,000 in aggregate



Paid leave provisions – Triggers

— The following reasons trigger paid leave provisions to apply to employers with fewer than 500 employees:

EPSL = Employee unable to work (or telework) because:

Employee subject to quarantine or isolation order related to COVID-19

Employee advised by healthcare provider to self-quarantine because of COVID-19

Employee experiencing symptoms of COVID-19 and seeking a diagnosis

The employee is caring for an individual subject to or advised to quarantine or isolate

The employee is caring for a son or daughter whose school or place of care is closed or unavailable due to COVID-19 precautions

The employee is experiencing substantially similar conditions as specified by the Secretary of Health and Human Services, in consultation with the Secretaries of Labor and Treasury

FMLA+ = Employee unable to work (or telework) because:

Employee is unavailable to work or telework to care for a minor child if the child's school or place of child care has been closedor is unavailable due to a public health emergency

Blue triggers = Full pay trigger capped at \$511 and 10 days (\$5,110)

Other triggers are 2/3rd pay capped at \$200 per day for the paid benefit period



CARES Act: Payroll tax deferral



Immediate impact on cash flow

Payment of applicable employment taxes for the payroll tax deferral period are deferred (effectively an interest-free loan from the government)

- Half due December 31, 2021
- Half due December 31, 2022

Payroll tax deferral period

— The period beginning on March 27, 2020 and ending on December 31, 2020

Applicable employment taxes are generally the employer share of social security taxes

- Also includes corresponding taxes imposed under the Railroad Retirement Act and on employee representatives, where applicable
- Applicable with respect to 50% SECA social security taxes (estimated taxes will not apply)

Can pair with ERC and PPP loan – now even after PPP loan has been forgiven



CARES Act: Paycheck Protection Program

- PPP expands on the Small Business Administration's (SBA) general business (§7(a)) loan program and includes the following terms:
 - Organizations must meet certain eligibility requirements and make a good faith certification that the current economic conditions make the loan necessary to support ongoing operations
 - Under the latest PPP legislation, the loans have a 5 year term and maximum principal amount of \$10 million (or lesser amount that depends on the organization's payroll)
 - Loan recipients benefit from a low interest rate (1%), waived personal guarantee and collateral requirements, and deferral of payments for specified periods
 - The entire principal amount and any accrued interest on the loan is eligible for forgiveness to the extent the proceeds are used to make payroll, payroll-related and other eligible payments (e.g., rent, mortgage interest, insurance premiums, utilities and interest on certain pre-existing debt) during a specified period following the receipt of loan proceeds
 - The portion eligible for forgiveness may be reduced if the organization reduces its workforce or compensation levels (or in some cases if it does not restore workforce and/or compensation to pre-COVID levels)



CARES Act: Employee Retention Credit



Potential \$5,000 credit per employee

Eligible employers receive 50% credit for qualified wages up to \$10,000 per employee (\$5,000 maximum credit per employee)

- Wages paid March 13, 2020 through and including December 31, 2020
 - Including allocable health expenses
- Credit against federal employment tax deposits (including FIT withholding)
 - Excess refunded
- Controlled group under §§52 and 414
- Applies ACA definition of full-time employee
- Precludes double benefits under workopportunity tax and leave credits
- Tax-exempt organizations may consider all operations without regard to "trade or business" requirement
- Wage deduction reduced by employee retention credit

Eligible Employer: carries on a trade or business during calendar year 2020 and *either* –

- Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate government authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19, or
- Over 50% reduction in quarterly gross receipts measured year over year



Note: Employer ineligible if receiving SBA Paycheck Protection Program Ioan



Additional CARES Act provisions



- Student loan assistance: Employers may contribute up to \$5,250 tax free toward the student loans of employees under a non-discriminatory arrangement
- Qualified plan distributions, withdrawals, loans: Additional flexibility provided in certain circumstances
- New "above-the-line" charitable contribution deduction:
 Until the end of 2020, individuals who do not itemize their deductions may deduct up to \$300 in cash contributions to public charities (but not DAFs/SOs) or operating foundations
- Charitable contribution limits raised: For cash contributions in 2020, individuals can deduct 100% of AGI and corporations can deduct 25% of taxable income to charities noted above





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Q+A

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