

## Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter Archive Message #691

Date:10-Apr-18

### Subject: Kelly Kidwell, Michael Geeraerts & Jim Magner: Will Colleges Be in the Section 4960 “Penalty Box” for Coaches’ Excess Compensation Under the New 21% Excise Tax?

*“The Tax Cuts and Jobs Act (TCJA) added IRC § 4960 which imposes an excise tax on tax-exempt organizations equal to the corporate tax rate, which is 21%, on compensation over \$1 million paid to any of its five highest-paid employees. Tax-exempt organizations that fall under this rule may have to get creative in how they compensate their top employees without running afoul of IRC § 4960 and having to pay 21% on excess compensation.*”

*College coaches are often the highest paid employees on campus, as was highlighted in 2016 with Jim Harbaugh’s \$5 million contract extension with the University of Michigan. But, in addition to his salary, Harbaugh and the University entered into a loan-regime split-dollar agreement, requiring the University to loan millions of dollars for the payment of Harbaugh’s life insurance premiums. It seems that split-dollar loans would avoid IRC § 4960, so these arrangements could become more prevalent with highly compensated college coaches and their employers looking to avoid the new excise tax. Perhaps the University of Michigan and Jim Harbaugh had a crystal ball when structuring their split-dollar agreement a few years ago.”*

In their commentary, **Kelly Kidwell, Michael Geeraerts** and **Jim Magner** discuss IRC § 4960 and how split-dollar arrangements may be a way around this new excise tax on compensation over \$1 million.

**Kelly Kidwell** is **President** and **CEO** of **Pacific Advisors**, a West Coast-based financial services firm that specializes in advanced estate, business, charitable and philanthropic planning. For the last four years, Kelly has been named a Top-of-the-Table producer by the Million Dollar Round Table Foundation, the industry’s most prestigious award. His professional memberships and achievements include being Chair of the Charitable Planning Committee for the Association for Advanced Life Underwriting

(AALU) and Leader of the Volunteer Planned Giving national program for the March of Dimes from 2001 to 2008. He is also a member of the National Association of Insurance and Financial Advisors (NAIFA) and a member of the Los Angeles Estate Planning Council. Pacific Advisors is a General Agency of The Guardian Life Insurance Company of America®.

**Michael Geeraerts, CPA, JD, CGMA®, CLU®** is an advanced planning consultant at **The Guardian Life Insurance Company of America®**.<sup>i</sup> Prior to joining Guardian, Michael was a manager at PricewaterhouseCoopers LLP and a tax consultant at KPMG LLP. Michael's experiences range from preparing tax returns for middle market companies, auditing billion-dollar mutual funds' financial statements, to researching unique tax savings strategies for various companies. Michael has written articles for numerous national publications and has delivered continuing education courses to CPAs and attorneys on a variety of estate, business and income tax planning strategies.

**Jim Magner** is an advanced planning attorney at **The Guardian Life Insurance Company of America®**. Prior to joining Guardian, Jim was General Counsel for a national broker dealer/brokerage general agency. Jim previously worked as an Attorney-Advisor in the IRS's Office of Chief Counsel, in Washington, DC. While with the Office of Chief Counsel, Jim wrote private and public rulings on estate, gift, GST and charitable remainder trust issues.

Here is their commentary:

## **EXECUTIVE SUMMARY:**

The Tax Cuts and Jobs Act (TCJA) created a 21% excise tax under new IRC § 4960 on compensation in excess of \$1 million paid to the five highest-paid employees of a tax-exempt organization. Section 4960 applies to organizations that are tax-exempt under section 501(a),<sup>ii</sup> farmers' cooperatives under section 521(b)(1),<sup>iii</sup> political organizations under section 527(e)(1),<sup>iv</sup> and state and local governmental entities with excludable income under section 115(1).<sup>v</sup>

Most private and public universities are tax-exempt under section 501(c)(3) because of their educational purposes. Public universities can also obtain

tax-exempt status because they are governmental entities and are not subject to federal income tax based on the principles of inter-governmental immunity (IRC § 115). Employers may look to implement creative planning techniques to avoid the application of section 4960, including the use of split-dollar arrangements and coordinating with third parties to supplement university compensation.

## COMMENT:

### **IRC § 4960 Excise Tax under TCJA**

IRC § 4960 imposes on tax-exempt employers a 21% tax on the sum of “the remuneration paid (other than any excess parachute payment) by an *applicable tax-exempt organization* for the taxable year with respect to employment of any *covered employee* in excess of \$1,000,000, plus any excess parachute payment paid by such an organization to any covered employee.”<sup>vi</sup> Remuneration is treated as paid when there is no substantial risk of forfeiture (within the meaning of section 457(f)(3)(B)).

Applicable tax-exempt organizations for purposes of section 4960 are:

1. exempt from taxation under section 501(a),
2. a farmers’ cooperative organization described in section 521(b)(1),
3. has income excluded from taxation under section 115(1), or
4. a political organization described in section 527(e)(1).<sup>vii</sup>

Covered employees are (a) the five highest compensated employees of the organization for the taxable year or (b) was a covered employee of the organization (or predecessor) for any preceding taxable year beginning after December 31, 2016.<sup>viii</sup>

Remuneration is considered to be wages (as defined under IRC 3401(a)), but not including any designated Roth contribution. Remuneration also includes amounts required to be included in gross income under IRC § 457(f). However, remuneration does not include the portion of any remuneration paid to a licensed medical professional (which includes veterinarians) for medical or veterinary services performed by that professional, which seems to be aimed at concerns that some tax-exempt hospitals may pay certain doctors more than \$1 million.

Note that remuneration includes remuneration paid for employment to a covered employee by a related person or government entity. A person or government entity is considered to be related to an applicable tax-exempt organization if the person or entity:

- controls, or is controlled by, the applicable tax-exempt organization;
- is controlled by a person, or persons, that control the organization;
- is a supported organization under IRC § 509(f)(3);
- is a supporting organization under IRC § 509(a)(3); or
- if the organization is a voluntary employees' beneficiary association (VEBA) under IRC § 501(c)(9), establishes, maintains, or makes contributions to that VEBA.

So, even if payment comes from one of these related entities and not directly from the tax-exempt employer, the excise tax under IRC § 4960 may still apply.

An excess parachute payment for purposes of the section 4960 excise tax is the excess of any "parachute payment" over the "base amount" allocated to the payment. A "parachute payment" is any payment made as compensation to, or for the benefit of, a covered employee if (i) the payment is contingent on the employee's separation from employment with the employer, and (ii) the aggregate present value of the compensation payments to, or for the benefit of, the employee is equal to, or greater than, three times the base amount. The "base amount" under section 4960 is determined in a similar manner as the "base amount" for golden parachute payments under section 280G(b)(3), which generally refers to an "individual's annualized includible compensation."

A parachute payment does not include any payment:

- (i) described in section 280G(b)(6) (relating to the exemption for payments under qualified plans),
- (ii) made under or to an annuity contract under section 403(b) or a section 457(b) plan,
- (iii) made to a licensed medical professional (including veterinarians) to the extent that the payment is for services performed by that medical professional, or

- (iv) made to an individual who is not considered a highly compensated employee under section 414(q).<sup>ix</sup>

### **College Coach Compensation**

According to data compiled by USA TODAY Sports, there are 90 head or assistant football coaches making more than \$1 million,<sup>x</sup> and that based on pay for the 2017 season, 65 public schools would have faced a combined total of about \$30 million in excise tax just for their football coaches. The salaries for men's basketball coaches average a little less than those for football coaches, but the potential excise tax hit remains significant in the basketball world.<sup>xi</sup>

The issue isn't germane only to coaches, as a recent compensation analysis of college coach and executive compensation undertaken by AthleticDirectorU in partnership with USA Today indicated that there are at least 240 coaches *and* athletic directors across the Division 1 Football Bowl Subdivision that receive compensation in excess of \$1,000,000.<sup>xii</sup>

### **Form 990 Disclosure**

The IRS requires nonprofit organizations to make their three most recent returns available for public inspection,<sup>xiii</sup> and the compensation information required to be disclosed for officers, directors, key employees and other highly compensated employees has long received attention in the nonprofit world. While compensation information is generally confidential in non-publicly traded organizations, that's not the case for not-for-profit colleges and universities.

Part VII of a university's publicly available Form 990 is where voluminous information about college coach compensation is disclosed, and this information is widely available through a number of reporting services.<sup>xiv</sup>

**Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors**

Check if Schedule O contains a response or note to any line in this Part VII

**Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees**

**1a** Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization's tax year.

- List all of the organization's **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
- List all of the organization's **current** key employees, if any. See instructions for definition of "key employee."
- List the organization's five **current** highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (Box 5 of Form W-2 and/or Box 7 of Form 1099-MISC) of more than \$100,000 from the organization and any related organizations.
- List all of the organization's **former** officers, key employees, and highest compensated employees who received more than \$100,000 of reportable compensation from the organization and any related organizations.
- List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than \$10,000 of reportable compensation from the organization and any related organizations.

List persons in the following order: individual trustees or directors; institutional trustees; officers; key employees; highest compensated employees; and former such persons.

Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and Title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(1)										
(2)										
(3)										
(4)										
(5)										
(6)										

Part II of Schedule J of Form 990 requires additional details about a coach or athletic director's compensation package to be reported:

**Part II Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees.** Use duplicate copies if additional space is needed.

For each individual whose compensation must be reported on Schedule J, report compensation from the organization on row (i) and from related organizations, described in the instructions, on row (ii). Do not list any individuals that aren't listed on Form 990, Part VII.

**Note:** The sum of columns (B)(i)-(iii) for each listed individual must equal the total amount of Form 990, Part VII, Section A, line 1a, applicable column (D) and (E) amounts for that individual.

(A) Name and Title	(i)	(B) Breakdown of W-2 and/or 1099-MISC compensation			(C) Retirement and other deferred compensation	(D) Nontaxable benefits	(E) Total of columns (B)(i)-(E)	(F) Compensation in column (B) reported as deferred on prior Form 990
		(i) Base compensation	(ii) Bonus & incentive compensation	(iii) Other reportable compensation				
1	(i)							
2	(i)							
3	(i)							
4	(i)							
5	(i)							
6	(i)							
7	(i)							
8	(i)							
9	(i)							
10	(i)							

Note that for Form 990 filing purposes, a “key employee” is defined as a person who is not an officer or director but has annual compensation of \$150,000 or more, meets the responsibility test and is one of the top 20 highest paid employees.<sup>xv</sup> “Highly compensated employees” are the five-highest compensated employees earning over \$100,000 who have not already been listed as an officer, director or key employee.

Column F asks for the amount of “other compensation” which generally includes any compensation that is not included on the W-2 form. Below are the primary items that are typically included in other compensation:

- Employer contributions into a defined contribution retirement plan,
- Increases in the actuarial value of defined benefit plan amounts,
- Employer paid health benefits,
- Employee health benefits paid with pre-tax dollars, and
- Nonqualified deferred compensation.<sup>xvi</sup>

### **Split-Dollar Disclosure**

Schedule L is typically where split-dollar loan arrangements are reported. As has been noted, “Schedule L loan regime reporting varies depending on whether the policy is owned by the executive alone or owned jointly with the employer, with employee-owned policies reported in Part II Loans to and/or From Interested Persons.”<sup>xvii</sup>

**SCHEDULE L  
(Form 990 or 990-EZ)**

**Transactions With Interested Persons**

OMB No. 1545-0047

Department of the Treasury  
Internal Revenue Service

▶ Complete if the organization answered "Yes" on Form 990, Part IV, line 25a, 25b, 26, 27, 28a, 28b, or 28c, or Form 990-EZ, Part V, line 38a or 40b.  
▶ Attach to Form 990 or Form 990-EZ.  
▶ Go to [www.irs.gov/Form990](http://www.irs.gov/Form990) for instructions and the latest information.

**2017**

**Open To Public Inspection**

Name of the organization

Employer identification number

**Part I Excess Benefit Transactions** (section 501(c)(3), section 501(c)(4), and 501(c)(29) organizations only).  
Complete if the organization answered "Yes" on Form 990, Part IV, line 25a or 25b, or Form 990-EZ, Part V, line 40b.

1	(a) Name of disqualified person	(b) Relationship between disqualified person and organization	(c) Description of transaction	(d) Corrected?	
				Yes	No
(1)					
(2)					
(3)					
(4)					
(5)					
(6)					

2 Enter the amount of tax incurred by the organization managers or disqualified persons during the year under section 4958. . . . . ▶ \$

3 Enter the amount of tax, if any, on line 2, above, reimbursed by the organization . . . . . ▶ \$

**Part II Loans to and/or From Interested Persons.**  
Complete if the organization answered "Yes" on Form 990-EZ, Part V, line 38a or Form 990, Part IV, line 26; or if the organization reported an amount on Form 990, Part X, line 5, 6, or 22.

(a) Name of interested person	(b) Relationship with organization	(c) Purpose of loan	(d) Loan to or from the organization?		(e) Original principal amount	(f) Balance due	(g) In default?		(h) Approved by board or committee?		(i) Written agreement?	
			To	From			Yes	No	Yes	No	Yes	No
(1)												
(2)												
(3)												
(4)												
(5)												
(6)												
(7)												
(8)												
(9)												
(10)												
<b>Total</b> . . . . . ▶						\$						

**Will the Use of Life Insurance & Third-Party Compensation Be Subject to Section 4960's Excise Tax?**

There are a number of creative planning techniques that may be implemented by employers seeking to avoid the application of section 4960. These include the use of split-dollar arrangements and coordinating with third parties to supplement university compensation. With regard to third-party coordination, it has been noted that:

It is reasonable to assume that Universities will renegotiate sponsorship agreements in a manner to allow the vendors/rights holders (including shoe and apparel companies, media partners and other licensing partners) to contract directly with and provide more cash directly to its coaches. In exchange for offloading compensation obligations to the vendors/rights holder, Universities may accept less favorable terms and/or lower product and in-kind discounts from its sponsors for their products and services.



For example, Virginia Tech's current Nike Contract provides for \$275,000 of Base (Cash) Compensation and a Supplied Product Limit of \$1,625,000. A more efficient structure, in light of § 4960, may be to (1) allow current coaches to contract directly with Nike, using university marks and other university property, and in exchange therefore, (2) agree to a lower Supplied Product Limit. Virginia Tech would then be able to use the increased cash available (from the offloaded coach compensation) to purchase additional product (presumably at an increase of less than 21%).<sup>xviii</sup>

IRC § 4960(d) directs the IRS to prescribe regulations to prevent the avoidance of the excise tax, including misclassifying employees as independent contractors or compensating employees through a pass-through or other entity to avoid the tax. Organizations should keep this in mind when structuring their compensation packages.

### **Will a Split-Dollar Arrangement Avoid IRC § 4960?**

For purposes of IRC § 4960, remuneration is considered to be wages (as defined under IRC § 3401(a)), but not including any designated Roth contribution. Remuneration also includes amounts required to be included in gross income under IRC § 457(f). IRC § 3401(a) states "For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash . . . ." The statute then goes on to list several exceptions, none of which appear to be directly on point with respect to split-dollar life insurance arrangements.

With respect to split-dollar arrangements, treasury regulation § 31.3401(a)-1(b)(15) states "See §1.61-22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements," which covers economic benefit regime split-dollar. Neither IRC § 3401 nor its treasury regulations specifically mention anything about loan-regime split-dollar. Treasury regulation § 1.61-22(a)(1) states "For the Collection of Income Tax at Source on Wages, this section also provides rules for the taxation of a split-dollar life insurance arrangement, other than a payment under a split-dollar life insurance arrangement that is a split-dollar loan under §1.7872-15(b)(1)."

As a general matter, loan-regime split-dollar arrangements under treasury regulation § 1.7872-15 are treated as loans, not as wages. IRC § 3401 and its treasury regulations make no mention of loan-regime split-dollar arrangements under treasury regulation § 1.7872-15, so it would appear that the loans under a loan-regime split-dollar arrangement are not treated as wages for purposes of sections 3401 and 4960, especially if the loan is not a below market loan, which most loan-regime split-dollar arrangements are structured to avoid. Note that foregone interest on split-dollar loans is generally treated as compensation to the borrower in an employer-employee relationship.

It was not that too long ago that we all read about the split-dollar arrangement between the University of Michigan and Jim Harbaugh. The University of Michigan is a tax-exempt entity, so the terms of the split-dollar plan were available for public disclosure. The terms of that split-dollar agreement required the University of Michigan to loan Harbaugh \$4 million in 2016 and an additional \$2 million for the following five years to pay the premiums on a life insurance policy that he owns. Insurance experts estimated that given the size of these premiums that the policy's face amount for a person Harbaugh's age would be approximately \$75 million. It would seem that other than any foregone imputed income due to the interest on the loans (equal to the loans times the applicable federal rate), the loans themselves escape the excise tax under IRC § 4960 because the loans are not considered remuneration.

Note that economic benefit regime split-dollar could also be used. The economic benefit costs would be remuneration under IRC § 4960, but the economic benefit costs may be relatively low depending on the circumstances, and this may provide another method of providing "compensation" to coaches and other employees without triggering the excise tax.

## **Conclusion**

IRC § 4960 is likely to change how college coaches' compensation packages are structured. It will be interesting to see how colleges respond to this new excise tax and how they change their compensation packages, and what they use to attract top talent. Split-dollar arrangements may have renewed attractiveness under the new law. Perhaps the University of

Michigan and Jim Harbaugh had a crystal ball when structuring their split-dollar agreement a few years ago.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

*Kelly Kidwell*  
*Michael Geeraerts*  
*Jim Wagner*

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<sup>i</sup> Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation. Not practicing for Guardian or any subsidiaries or affiliates thereof. 2018-57695 (Exp. 4/2020).

<sup>ii</sup> “An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is

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denied under section 502 or 503.” IRC § 501(a). Organizations operated exclusively for “educational purposes” fall under IRC § 501(c)(3).

iii “The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.” IRC § 521(b)(1).

iv “The term “political organization” means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.” IRC § 527(e)(1).

v “Gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia.” IRC § 115(1).

vi IRC § 4960(a).

vii IRC § 4960(c)(1).

viii IRC § 4960(c)(2).

ix IRC § 4960(c)(5).

x <http://sports.usatoday.com/ncaa/salaries/>.

xi <http://sports.usatoday.com/ncaa/salaries/mens-basketball/coach/>.

xii <https://athleticdirector.uconn.edu/articles/how-the-new-excise-tax-impacts-coach-compensation/>.

xiii IRC § 6104.

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<sup>xiv</sup> See [www.guidestar.org](http://www.guidestar.org).

<sup>xv</sup> The responsibility test is met if the individual has influence over the organization as a whole similar to that of an officer or director, or manages a segment of the organization that represents 10% of the organization's activities, assets, revenue or expenses or has the authority to control 10% or more of the organization's capital expenditures, operating budget or compensation for employees.

<sup>xvi</sup> <https://www.kahnlitwin.com/blogs/mission-matters-blog/form-990-compensation-information>.

<sup>xvii</sup> <http://www.triscendnp.com/wp-content/uploads/2013/12/How-to-Report-SERPs-Split-Dollar-on-Form-990.pdf>

<sup>xviii</sup> <https://athleticdirector.uconn.edu/articles/how-the-new-excise-tax-impacts-coach-compensation/>.