Simpson Thacher

Memorandum

IRS Notice 2026-36 on Section 4960

August 5, 2026

Executive Summary

On June 5, 2026, the Department of the Treasury ("Treasury Department") and the Internal Revenue Service (the "IRS") issued Notice 2026-36 (the "Notice"), announcing their intent to issue proposed regulations under section 4960 of the Internal Revenue Code of 1986, as amended (the "Code"). Code section 4960 imposes an excise tax on certain compensation paid to any "covered employee" of an applicable tax-exempt organization (an "ATEO"). The One Big Beautiful Bill Act ("OBBBA") expanded the scope of Code section 4960 by broadening the definition of a "covered employee."[1] According to the Notice, the proposed regulations are anticipated to reflect the OBBBA amendments to the definition of covered employee and to provide certain exceptions to that definition. Until the forthcoming proposed regulations are issued, ATEOs may rely on the rules described in the Notice.

I. HISTORY OF CODE SECTION 4960 AND THE CURRENT REGULATIONS

Code section 4960 was added to the Code by section 13602 of the Tax Cuts and Jobs Act[2] ("TCJA") and is effective for taxable years beginning after December 31, 2017. Code section 4960 imposes an excise tax at the corporate tax rate, currently 21%, on (i) remuneration (other than any excess parachute payments) in excess of $1 million for any taxable year, and (ii) any excess parachute payment, in either case, paid to any covered employee.

The TCJA defined a "covered employee" as any employee or former employee of an ATEO who (i) is one of the five highest-compensated employees of the ATEO for the current taxable year or (ii) was a covered employee of the ATEO or any predecessor for any preceding taxable year beginning after December 31, 2016. Once an employee is a covered employee of an ATEO, he or she will always be a covered employee.

Regulations were published in the Federal Register on January 19, 2021, with an effective date of January 15, 2021, and are applicable for tax years beginning after December 31, 2021 (the "Current Regulations").[3] The Current Regulations set forth three specific exceptions for purposes of determining an ATEO's five highest-compensated employees for a taxable year and, thus, its covered employees: the "limited hours," "nonexempt

[1] Pub. L. 119-21, 139 Stat. 72, 223.

[2] Pub. L. 115–97, 131 Stat. 2054, 2157.

[3] Treas. Reg. §§ 53.4960-0 through 53.4960-5, 86 Fed. Reg. 6196 (Jan. 19, 2021).

funds" and "limited services" exceptions. These exceptions serve only to exclude employees from the first prong of the original TCJA definition of covered employee (*i.e.*, as one of the five highest-compensated employees for the taxable year). The exceptions provide no relief in the case of an individual that was previously determined to be a covered employee for any preceding taxable year beginning after December 31, 2016, and thus is included under the second prong of the definition of covered employee.

II. CODE SECTION 4960 UNDER THE OBBBA AND THE NOTICE.

On July 4, 2025, Congress enacted the OBBBA. The OBBBA expands the definition of a "covered employee" under Code section 4960 to include any employee or former employee of an ATEO, with such amendment applicable to taxable years beginning after December 31, 2025. In other words, the amendment eliminated the five highest-compensated employees concept. This amendment left uncertain the exceptions in the Current Regulations, which relate to status as one of the five highest-compensated employees, not to status as a covered employee.

The Notice states that the prior definition is expected to be retained for taxable years beginning on or before December 31, 2025, including for purposes of retroactive determinations made in a taxable year beginning after December 31, 2025. Accordingly, the definition of covered employee, as amended by the OBBBA, includes only (i) individuals who were employed by an ATEO in any taxable year beginning after December 31, 2016 and on or before December 31, 2025, only to the extent they were covered employees under the prior definition, and (ii) any individual employed by an ATEO in a taxable year beginning after 2025, unless an exception provided in future guidance applies.

The Notice further states that the forthcoming proposed regulations are expected to provide exceptions similar to the limited hours and nonexempt funds exceptions in the Current Regulations to status as a covered employee. A limited services exception, however, is not expected to be provided in the proposed regulations.

The Notice provides welcome news for ATEOs (and their related organizations) who have historically relied on the limited hours and nonexempt funds exceptions.

Until the forthcoming proposed regulations are issued, ATEOs may rely on the rules described in the Notice that are anticipated to be included in the proposed regulations.

For more information, please contact any member of our Exempt Organizations Group:

CONTACTS

David A. Shevlin
+1-212-455-3682
dshevlin@stblaw.com

John N. Bennett
+1-212-455-2000
jbennett@stblaw.com

Maura L. Whelan
+1-212-455-2494
mwhelan@stblaw.com

Jennifer L. Franklin
+1-212-455-3597
jfranklin@stblaw.com

Anne Power
+1-212-455-7582
anne.power@stblaw.com

Daniel Solecki
+1-212-455-3511
daniel.solecki@stblaw.com

Ian Bowe
+1-212-455-7083
ian.bowe@stblaw.com