



Global Reward Services Quarterly Newsletter

March 2021

KPMG LLP's (KPMG) Global Reward Services Quarterly Newsletter brings you compensation and reward developments, along with KPMG observations from around the world.

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Americas



Canada: Update on Changes to the Tax Treatment of Employee Stock Options

On November 30, 2020, the Canadian federal government announced that it intends to proceed with the proposed rules to limit the deduction for employee stock options. These new rules will be effective and apply to stock options granted on or after July 1, 2021.

Broadly, the new rules include the following provisions:

- A CA\$200,000 annual limit will apply to employee stock option grants that qualify for the employee stock option deduction. This limit will be based on the fair market value of the shares underlying the options, at the time the options are granted, and will be computed by reference to the vesting schedule.
- Employee stock options granted by a Canadian-controlled private corporation (CCPC) will not be subject to the new rules.

- Employee stock options granted by non-CCPCs with annual gross revenues of CA\$500 million or less will also not be subject to the new stock option limits.
- A corporate tax deduction will be available with respect to the benefit related to the stock options that would otherwise qualify for the stock option deduction but for the CA\$200,000 limitation.

KPMG observations:

Canadian employers that fall within the scope of the new rules should determine how their stock options will be affected. Employers may want to consider granting stock options prior to the July 1, 2021 effective date to take advantage of the beneficial tax treatment for employees under the current rules. Companies may also consider granting other forms of stock-based compensation once the deduction limitation rules become effective. If stock options will be granted under the new rules, companies should set up internal systems to track all stock option grants and ensure they have the capabilities to support the administration of the different tax treatments.



United States – Compensation and Benefits-Related Provisions in COVID-19 Relief Bill

On March 10, 2021, the U.S. House of Representatives approved the American Rescue Plan Act of 2021 (Rescue Act), thus completing congressional action on the legislation. The Rescue Act includes several compensation and benefits-related provisions including measures that:

- Extend and expand the employee retention credit (ERC) through December 31, 2021
- Extend and expand the paid sick leave and the expanded Family Medical Leave Act (FMLA) credit as originally provided by the Families First Coronavirus Response Act (FFCRA) through September 30, 2021.
- Expand the “covered employee” definition under section 162(m), thereby limiting the deduction for certain employee compensation for public companies for tax years beginning after December 31, 2026.

ERC extension and expansion: The Consolidated Appropriations Act, 2021 (CAA 2021) expanded the employee retention credit (ERC) through the second quarter of 2021. The Rescue Act further extends the expanded ERC through December 31, 2021. However, the credit is now applied against Medicare instead of Social Security. Any excess credit remains refundable. Amendments included in the Rescue Act apply to tax quarters after June 30, 2021.

The Rescue Act clarifies that qualified wages under the ERC do not include wages taken into account for the new restaurant revitalization grant also provided for under the Rescue Act.

The Rescue Act provides that “severely financially distressed employers” may treat all wages paid to employees as qualified wages, regardless of the size of the employer and number of employees. A “severely financially distressed employer” is an employer that experienced a gross receipts reduction of more than 90 percent as compared to the same quarter in 2019.

In addition, the Rescue Act extends the period for assessment for a taxpayer taking the ERC to five years (from the usual three years).

The expansion for severely financially distressed employers only applies for the third and fourth quarters of 2021. The amendments to the ERC made by the Rescue Act are effective for calendar quarters after June 30, 2021.

Paid sick leave and extended FMLA: The FFCRA required certain employers to provide paid sick leave and expanded FMLA leave and provided a full tax credit to the employer for the paid leave. In CAA 2021, the leave provisions were extended through March 31, 2021, and became voluntary and not required for the same group of employers. Also, the credits were extended if the employer chose to provide the leave.

The Rescue Act further extends the voluntary leave and credits through September 30, 2021. In addition, the expanded FMLA is increased from 50 days to 60 days (and the amount of the credit is increased up to \$12,000, from \$10,000). The amount of eligible sick leave restarts on April 1, and employers can provide up to 10 days of leave through September 30, 2021.

The Rescue Act further expands the leave provisions to include leave for obtaining a COVID-19 vaccination or leave for recovering from a COVID-19 vaccination.

Expanded section 162(m) “covered employee” definition: Section 162(m) limits the deduction for compensation paid to each covered employee to \$1 million for public companies. Covered employees generally include the CEO, CFO, and three highest-paid officers as determined under the U.S. Securities and Exchange Commission (SEC) rules in a tax year as well as such individuals previously identified as covered employees for any prior tax year beginning after December 31, 2016.

The Rescue Act provides that section 162(m) covered employees include the “five highest-paid employees” in addition to the existing covered employees (CEO, CFO, and the three highest-paid executive officers) included in the section 162(m) limitation. This provision is applicable for tax years beginning after December 31, 2026.

For more information, read the [January](#) and [March](#) KPMG reports.

KPMG observations:

1. The addition of the five highest-paid employees appears to be an annual determination, and they are not automatically deemed to be covered employees under a “once a covered employee always a covered employee” rule in future years. Only the traditional five covered employees (CEO, CFO, and three highest-paid officers) remain covered employees in all future years.

2. This addition of the five highest-paid employees standard was a surprising late addition made during Senate deliberations of the legislation. While there is a delay in the effective date (i.e., tax years beginning after December 31, 2016), this provision is being viewed as being a significant increase to the number of covered employees starting in tax years beginning after 2026. While the delayed effective date provides some time for rules to be developed, many taxpayers will need to consider now what could be the impact to their deferred tax assets.



United States: Section 162(m) Final Regulations

On December 18, 2020, the IRS released the final regulations (T.D. 9932) under the section 162(m) deduction limitation on executive compensation rules. The final regulations touch on several concerns expressed by taxpayers, which we have summarized below:

Publicly held corporations: The final regulations generally tracked the proposed regulations’ definition of publicly held corporation and clarified that a real estate investment trust (REIT) that owns a qualified REIT subsidiary is a publicly held corporation if it issues securities required to be registered under section 12(b) of the Securities Exchange Act of 1934 (Exchange Act) or is required to file reports under section 15(d) of the Exchange Act.

Affiliated group: Under the final rules, compensation paid by all members of the affiliated group is aggregated. Any amount disallowed as a deduction by section 162(m) is prorated among the payor corporations. Compensation paid by a member of an affiliated group that is not a publicly

held corporation to an employee who is a covered employee of two or more other members of the affiliated group is prorated for purposes of determining the deduction disallowance among the members that are publicly held corporations.

Covered employee: The term now includes employees of a predecessor of the publicly held corporation for a preceding tax year beginning after December 31, 2016. A predecessor corporation can include a corporation that has had greater than 80 percent of its gross operating assets purchased by the acquiring corporation.

Applicable employee remuneration: The final regulations use the term “compensation” rather than “applicable employee remuneration” when possible. “Compensation” consists of an amount that is includible in the income of, or paid to, a person other than the covered employee. This includes income after the death of the covered employee, consistent with section 162(m)(4)(F).

The final regulations also modify the applicability date of the definition of compensation related to partnerships to provide additional transition relief for umbrella partnership C corporations (Up-C).

Privately held corporations that become publicly held (including IPO exception): The final regulations adopt the transition relief in the proposed regulations that a privately held corporation that becomes a publicly held corporation on or before December 20, 2019, generally may rely on the transition rules provided in section 1.162-27(f)(1) and (2) of the 1995 regulations.

Grandfather rule: Treasury and the IRS reconsidered the approach regarding the recovery of compensation when the corporation is obligated, or has discretion, to recover compensation paid in a tax year upon a future occurrence of a condition outside the corporation’s control. The final regulations provide that a corporation’s right to recover compensation does not affect the determination of the amount of compensation the corporation has contracted for in a binding contract to pay under applicable law as of November 2, 2017. This holds true regardless of whether the corporation exercises its discretion to recover any compensation if the contracted condition subsequently arises.

Ordering rules: The final regulations permit the grandfathered amount to be allocated to the last otherwise deductible payment, or to each payment on a pro rata basis, for tax years ending before December 20, 2019. However, the ordering rule requiring the grandfathered amount to be allocated to the first otherwise deductible payment under the arrangement must be used for tax years ending on or after December 20, 2019, regardless of the method for allocating prior to that date.

Limited to a particular plan or arrangement: The grandfathered amount payable under a plan or arrangement applies solely to the amounts paid under that plan or arrangement. This is regardless of whether the entire grandfathered amount is paid to the employee. No portion of the grandfathered amount may be treated as a grandfathered amount under any separate plan or arrangement.

Material modification: The final regulations provide that a modification of the contract after November 2, 2017, to offer an additional predetermined actual investment or substitute a predetermined actual investment as an investment alternative under the arrangement is **not** a material modification.

A subsequent deferral will not be considered a material modification if any additional amount is based on either a reasonable rate of interest or a predetermined actual investment. However, the additional amount will not be treated as grandfathered.

Coordination with section 409A: The final regulations incorporate the section 409A regulatory provisions. They provide that if compensation attributable to the exercise of a nonstatutory stock option or a stock appreciation right (SAR) is grandfathered and the exercise period of the option or SAR is extended, then all compensation attributable to the exercise of the option or the SAR is grandfathered if the extension complies with Reg. section 1.409A-1(b)(5)(v)(C)(1).

However, until final guidance under section 409A is issued, taxpayers may continue to rely on the preamble to the proposed regulations.

Applicability dates: The final regulations apply to tax years beginning on or after the date of publication in the Federal Register. Taxpayers may choose to apply the final regulations to a tax year beginning after December 31, 2017, so long as the taxpayer applies the final regulations in their entirety and in a manner consistent with that tax year and all subsequent tax years.

For more information, read our [KPMG report](#).

KPMG observations:

While many of these changes have been made available since the proposed regulations were released in 2018, employers should review the applicability dates confirmed by the final regulations to determine how their plans and arrangements will be affected.



United States: Final Section 4960 Regulations on Excise Tax for Excess Remuneration and Excess Parachute Payment

On January 19, 2021, the IRS published its final regulations (T.D.9938) for the excise tax imposed regarding excess tax-exempt organization executive compensation. These regulations implement code section 4960 as added to the Code by the 2017 Tax Cuts and Jobs Act (TJCA). Section 4960 provides that an “applicable tax-exempt organization” (ATEO) that pays a “covered employee” remuneration in excess of \$1 million or any excess parachute payment in an applicable year is subject to an excise tax. The final regulations apply to tax years beginning after December 31, 2021.

This discussion focuses on the modifications made in the final regulations.

Covered employee: The excise tax potentially applies only to amounts paid to a “covered employee” of an ATEO. A covered employee is defined in the statute as any employee (including any former employee) of an ATEO if the employee “is one of the five highest-compensated employees of the organization for the taxable year” or “was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.” The final regulations include the following clarifications and modifications related to the determination of covered employees:

- The preamble clarifies that taxable fringe benefits—such as employer-provided parking in excess of the value excluded under section 132—are considered compensation for the purpose of determining an ATEO’s five highest-compensated employees and applying the exceptions from covered employee status. The proposed regulations had requested comments on this issue, but none was received.
- The final regulations maintain the exceptions in the proposed regulations that permit an ATEO to disregard individuals for purposes of determining the ATEO’s five highest-compensated employees (that is, its covered employees) for an applicable year. Under the broadest of these exceptions—the “nonexempt funds exception”—individuals may be disregarded if:
 - » They have not received remuneration (or any legally binding right to nonvested remuneration) from the ATEO, any related ATEOs, or any taxable related organizations controlled by the ATEO and/or related ATEOs for services provided to the ATEO.
 - » They did not perform services for the ATEO and related ATEOs in excess of 50 percent of their total hours worked for the ATEO and all of its related organizations.
 - » Any related organization that paid remuneration to the individuals has not provided services for a fee to the ATEO, to any related ATEOs, or to any taxable related organizations controlled by the ATEO and/or related ATEOs.

The final regulations modified this exception in two respects:

- The relevant measurement period for applying the 50-percent-of-total-hours threshold (as well as other requirements) is increased from one applicable year to two applicable years (with the current applicable year and the preceding applicable year being treated as a single measurement period). This change allows flexibility for employees of a related organization to rotate to an ATEO to provide services for a period of longer than six months (or if an employee unexpectedly provides services beyond six months).
- In determining whether a taxable related organization is “controlled by the” ATEO for purposes of this exception, ATEOs may disregard the application of “downward attribution” in applying section 318(a)(3) to corporations and other entities and in applying section 318 principles to nonstock organizations. Note that this modification is only for purposes of this nonexempt funds exception and not for purposes of determining whether an organization is related generally.

Coordination with section 162(m): Treasury and the IRS have not yet determined the appropriate manner in which code sections 4960 and 162(m) should be coordinated. The final regulations reserve a section for future guidance. Taxpayers may use a reasonable, good faith approach with respect to coordination of section 4960 and section 162(m) in circumstances in which it is not known whether a deduction for remuneration will be disallowed under section 162(m) by the due date (including extensions) of the relevant return on which the excise tax is reported (Form 4720).

A reasonable, good faith approach must have a reasonable basis for anticipating that the compensation that a particular employee will be paid in the future may be subject to the deduction limitations of section 162(m). It is not reasonable to anticipate that an ATEO may become a public corporation by the date the compensation will be paid, absent facts indicating that is a realistic potentiality.

The two approaches regarding deferred compensation described in the preamble to the proposed regulations are considered reasonable, good faith approaches. This includes allowing an employer to exclude an amount from remuneration if it is reasonably expected to be disallowed under section 162(m) and offsetting remuneration subject to section 4960 in a later tax year by an amount equal to the amount that was treated as excess remuneration under section 4960 in a previous tax year for which a deduction is subsequently disallowed.

Effective dates: The final regulations apply to tax years beginning after December 31, 2021 (with the first applicable year generally being the 2022 calendar year).

Prior to the effective date of the final regulations, taxpayers may rely upon the guidance in Notice 2019-09 in its entirety or the proposed regulations in their entirety. Alternatively, taxpayers may choose to apply the final regulations to tax years beginning after December 31, 2017, and on or before December 31, 2021, provided they apply the final regulations in their entirety and in a consistent manner.

For more information, read our [KPMG report](#).

KPMG observations:

The final regulations contain several modifications from the proposed regulations. Furthermore, the IRS is still considering certain issues that were not implemented under the current regulations. Until the IRS releases guidance clarifying such issues, affected ATEOs may use a reasonable, good faith approach with respect to such issues, as provided in the final regulations.



China: Preparing for Potential Changes to IIT Preferential Treatment

There is continued uncertainty over whether China's preferential individual income tax (IIT) policy will be extended beyond 2021. The amended IIT law, which came into effect January 1, 2019, included changes to individual tax rates, residency rules, categories of taxable income, among many other fundamental tax law areas. The new rules also addressed the tax treatment of annual bonuses, equity-based incentives, and certain expatriate fringe benefits.

Following the enactment of the IIT law, the Ministry of Finance and the State Administration of Taxation jointly released Circular 164 providing transitional measures for the application of the preferential tax treatment of benefits provided to employees, including annual bonuses, equity-based compensation, and fringe benefits. The transitional period under Circular 164 is effective until December 31, 2021, at which time these measures are scheduled to expire.:

Equity-based compensation preferential treatment

One example of the preferential tax treatment under the current rules set to expire at the end of 2021 is the calculation of taxes payable on equity award income. Under the transitional rules, qualified equity-based compensation income can be treated as a separate source of income from comprehensive income for IIT calculation purposes resulting in a lower marginal tax rate for the individual.

With the possibility of this preferential treatment ceasing to apply as of 2022, companies should begin taking the necessary steps for tax planning for the 2022 tax year.

For more information, read our recent [KPMG Flash Alert](#).

KPMG observations:

KPMG China anticipates the announcement of guidance from the Chinese authorities in the coming months regarding the tax treatment of the affected compensation items discussed above. In the event of a new policy update, employers should perform a cost analysis by reviewing and adjusting company compensation policies to facilitate attracting and retaining talent. Companies should communicate with employees in a timely manner on potential regulatory changes and their financial impact on compensation provided to employees.



Ireland: Share Schemes Reporting Deadline and New Electronic Reporting Requirements

The March 31 mandatory due date looms for the filing of 2020 information returns for employee share schemes under Ireland's Finance Act 2020 (the Act). Under the Act, the Irish tax authorities (Revenue Commissioners) also established new electronic employer reporting requirements for certain share schemes.

The deadline is particularly important for companies whose employees and directors have participated in unapproved share options schemes, key employee engagement programme (KEEP) options, or certain Revenue Commissioners-approved share participation schemes. The Revenue Commissioners have indicated that the deadline to file the employer returns will not be extended beyond March 31, 2021, unlike for 2019 reporting where the deadline was extended due to the COVID-19 pandemic.

Here is a summary of the different share plans and related reporting requirements.

Unapproved share options – Form RSS1

The 2020 Form RSS1 requires reporting of the grant, release, assignment, and exercise of options awarded to directors and employees in Ireland. Reporting on this form is not required for awards that have been subject to pay-as-you-earn (PAYE) deductions through payroll (including restricted and forfeitable shares and the vesting of restricted stock units). The Form RSS1 must be submitted in electronic format.

Key employee engagement programme – Form KEEP 1

KEEP options are tax-favored options originally introduced by the Finance Bill 2017. These options allow employees to exercise qualifying options without triggering an income tax liability at such time. The 2020 Form KEEP 1, like the RSS1, must be submitted electronically and requires the reporting of the grant, release, assignment, and exercise of KEEP options by participating employees and directors.

Approved profit-sharing schemes (APSS) – Form ESS1

Employers must report details of certain events and share transactions held by an APSS trust. The information return Form ESS1 must now be delivered to the Irish tax authorities in an electronic format and the APSS trust must be registered for income tax, with its own tax reference number.

The electronic Forms RSS1, KEEP1, and ESS1 are in a spreadsheet format that must be uploaded on the Revenue Online Service (ROS). Only registered ROS users may access and upload returns.

A separate March 31, 2021 filing requirement applies to the following Revenue-approved share participation schemes:

- Save as you earn options
- Employee share ownership trust transactions.

These filings continue to be in paper form.

New employer reporting requirement for other share schemes

The Act also provides for reporting in electronic format for returns of information on share plans that had no prior prescribed reporting format. The electronic reporting form is expected to cover:

- Restricted shares
- Forfeitable shares
- Convertibles shares
- Restricted stock units
- Other share awards.

The electronic form for these plans is not yet available. The Revenue Commissioners recently indicated that it may extend the deadline for the electronic reporting for these plans to July 2021 with the exact due date still to be confirmed.

For more information, read our [KPMG Flash Alert](#).

KPMG observations:

The new reporting requirements will allow the Revenue Commissioners to efficiently gather significant detail on relevant plans and will provide them with greater visibility to the operation of such plans by companies. Employers should review their procedures for reporting information related to share plans and update such procedures to include the required information for the electronic reporting format. Employers should also ensure they are registered for ROS use in order to upload the necessary returns. Companies that fail to comply with these mandatory filing obligations may receive a monetary penalty or have the Revenue approval withdrawn for the Revenue Commissioners–approved schemes.

Contact us

Michael A. Bussa
Partner and Global Reward Services Leader
T: 212-954-1811
E: mbussa@kpmg.com

Jill Hemphill
Partner
T: 212-954-1942
E: jhemphill@kpmg.com

Kathy Lo
Principal
T: 415-963-8988
E: kathylo@kpmg.com

Terrance Richardson
Principal
T: 214-840-2532
E: trichardson@kpmg.com

Parmjit Sandhu
Principal
T: 212-954-4063
E: parmjitsandhu@kpmg.com

Leann Balbona
Managing Director
T: 212-872-3671
E: lbalbona@kpmg.com

Jennifer Link
Managing Director
T: 212-909-5381
E: jlink@kpmg.com

Kerri McKenna
Managing Director
T: 267-256-1951
E: kerrimckenna@kpmg.com

Mark Spittel
Managing Director
T: 214-840-4394
E: mspittel@kpmg.com

Dinesh Sinniah
Managing Director
T: 312-665-3603
E: dsinniah@kpmg.com

Eric Schecter
Managing Director
T: 212-954-7077
E: eschecter@kpmg.com

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