Global Reward Services Quarterly Newsletter

January 2023

The 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

United States: Penalty notices for errors on Form 1042-S

The U.S. Internal Revenue Service (IRS) intends to identify errors on Form 1042-S (Foreign Person's U.S. Source Income Subject to Withholding) to impose penalties and send out notices for incorrectly submitted forms by using a data-integrity tool. This tool was developed for withholding agents to perform quality checks on the data before submitting forms to the IRS.

A director of field operations at the IRS reportedly stated that the tool helped the IRS in identifying a lot of errors in Form 1042-S data. These data errors are considered "low-hanging fruit" for which they will start issuing more penalty notices.

For more information, read our KPMG Flash Alert.

KPMG observations

For reporting certain payments to non-U.S. employees subject to U.S. withholding, employers with global reward programs are frequently required to issue Form 1042-S. However, the IRS claims that this form is often filled incorrectly. The data-integrity tool will help to identify such errors and issue more penalty notices.

Payments in the form of equity awards to nonresident directors would be impacted as a result of this new focus; therefore, it is important to complete these forms accurately to avoid penalties.

This stepped-up enforcement effort of identifying errors is due to the funding increase stated under the Inflation Reduction Act. The additional funding to the IRS includes USD 45.6 billion related to tax enforcement. The IRS is actively investigating form 1042-S compliance issues to conduct suitable examinations, wherever required.

Asia Pacific

Australia: Employee Share Scheme (ESS) reporting

It is mandatory for employers to report taxable ESS events, covering all forms of equity compensation, including shares, performance rights, and options. Below are the regulatory obligations imposed by the Australian Taxation Office (ATO) for the current tax year ending June 30, 2023:

- Provide ESS statements to employees by July 14
- Submission of the ESS annual report to the ATO by August 14

Additionally, the ESS annual report should be lodged electronically in compliance with the software specifications defined by the ATO. The ATO may impose penalties on an employer for failing to lodge an ESS Annual Report

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with the ATO or failing to issue an ESS statement to an employee. In the case of a Significant Global Entity (SGE)*, the penalties are multiplied, and can be up to A$555,000 for failing to lodge an ESS Annual Report with the ATO. Penalties may also be imposed where these documents contain errors or mis-statements.

**An SGE includes a global parent entity (GPE) with an annual global income of A$1 billion or more; or a member of a group of entities consolidated for accounting purposes as a single group and one of the other group members is a GPE with an annual global income of A$1 billion or more*

For more information, read our KPMG Flash Alert.

KPMG observations

The reporting requirements can be complex, given multiple legislative changes have occurred over years, resulting in different rules applying depending upon when the awards were granted. This makes it difficult for employers to complete the reporting in-house with the ATO-mandated software specifications, not to mention the rising globally mobile workforce and increased employer reporting obligations by the ATO.

Therefore, employers can leverage **ESS Assist**, the KPMG technology solution that automates ESS reporting obligations calculations by sourcing data directly from the share plan administrators. It includes generation of bespoke cover letters, wherein each ESS statement contains calculations explained in plain English to reduce employee queries. Please reach out to your usual KPMG contact for further information.

China: Preferential tax treatment for equity income extended

The preferential tax treatment for equity income in China expired on December 31, 2022. The preferential tax treatment permitted income that is derived from equity incentive plans to be taxed as a separate source of income, by which the effective tax rate could generally be lowered, provided the plan was registered with the local tax authorities. The tax filing deadline for income received in the month of January 2023 is February 15, 2023.

The tax authorities updated the relevant tax regulation on January 16, 2023 to extend the preferential tax treatment on equity income for one more year until December 31, 2023.

In the absence of an extension, equity income would have needed to be consolidated together with regular salary for tax calculation purposes.

For more information, read our KPMG Flash Alert.

KPMG observations

This is good news for Chinese plan participants, who can continue to enjoy lower tax rates on equity compensation earned in China. However, companies should continue to monitor this in Q4 2023 prior to the expiration of the relief.

India: New exchange control rules for share-based awards offered to Indian residents

The new Indian foreign exchange regulations related to share award programs and the required reporting have been published. The regulations entered into effect on August 22, 2022.

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Below is a brief overview of the pre-and post-August 2022 rules and the change impacting the share-based awards offered to Indian residents by non-Indian issuers:

Prior to the new regulations, any person resident in India, being an individual who is an employee or a director of Indian office or branch of a foreign entity or of a subsidiary in India of a foreign entity or of an Indian company in which a foreign entity has direct or indirect equity holding, could accept the shares offered by such foreign entity provided that:

- The shares under the ESOP scheme are offered by the issuing company globally on a uniform basis
- An annual return is submitted by the Indian company to the Reserve Bank of India through the authorized dealer bank giving details of remittances/beneficiaries, etc.

With the introduction of the new regulations, the above clauses broadly remain the same. The only change is the timing of filing of the return, wherein the Indian entity will have to file the relevant form (Form OPI) within 60 days of the periods ending March 31 and September 30.

For more information, read our KPMG Tax Flash News.

KPMG observations

Historically, if the above requirements were not met, foreign issuers were required to obtain approval from the Reserve Bank of India (RBI) prior to issuing share-based awards. Note annual filings were required to be furnished to the RBI where exemptions were applicable. Exemptions included either "general permissions" or "cashless exercise" exemptions, or if your organization qualified for an exemption under the Liberalized Remittance Scheme (LRS). The new Overseas Investment (OI) Rules only provide for a new "general permission" exemption for foreign organizations granting awards to employees of their Indian entities under an ESOP. The requirements of the new general permission mostly align with the old rules, except that the Indian entity must now submit semiannual reports on Form OPI to the RBI through its authorized dealer bank within 60 days of the periods ending March 31 and September 30.

Keeping with the spirit of liberalization and to promote ease of doing business, the Central Government and the Reserve Bank of India have been progressively simplifying the procedures and rationalizing the rules and regulations under the Foreign Exchange Management Act, 1999. In this direction, the introduction of the new regulations is a significant step with regard to operationalization of a new OI regime.

Companies should review their regulatory position to determine which exemptions have been relied upon for prior grants to Indian resident employees and whether the new general exemption remains available. Companies should also ensure that their Indian reporting team is aware of the new requirements and reporting timelines and collects the data needed for reporting purposes well in advance. KPMG is happy to assist companies in this process.

New Zealand: Amendments to certain nonresident employer reporting obligations

The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill released by New Zealand's government proposes several changes to the tax system, including modifications to the reporting requirements for nonresident employers with employees working in New Zealand. The bill is subject to further review before being put into effect.

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Employers who make payments or offer benefits that are taxed in New Zealand have certain obligations that can be inflexible, requiring substantial information to be collated and provided to Inland Revenue, leading to significant compliance costs. The proposed changes will bring modernization and clarification to these obligations.

The proposed changes include:

- If an employee's presence breaches New Zealand domestic law or tax treaty exclusions, a 60-day grace period is provided to comply with the tax obligations (such as PAYE and FBT). This will take effect from April 1, 2024.
- A "safe harbor" from New Zealand employer tax obligations for nonresident employers who mistakenly believed that they had no PAYE or other employment-related tax liabilities. This will apply if either:
  - There are two or fewer employees present in New Zealand at any point in the income year, or
  - There is NZD 500,000 or less in gross employment-related taxes during the income year.

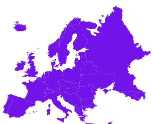
In these cases, the employee needs to satisfy any applicable New Zealand employment-related obligations (including FBT obligations on any fringe benefits received). This will be effective from April 1, 2023.

For more information, read our KPMG Flash Alert.

KPMG observations

The changes in the bill will provide a clearer approach for nonresident employers to meet withholding obligations and provide a lower-cost option for compliance. From a tax perspective, a 60-day threshold provides a more practical approach to cross-border employees. Remote working is gradually becoming a new style of working, which has seen a rise in the number of remote workers in New Zealand and employees working for their overseas employers. The proposed modifications will see an increase of instances wherein employees in New Zealand will become responsible for their own tax withholding requirements.

Europe



Ireland: Irish Revenue introduces enhanced employer reporting requirements

Additional employer reporting requirements have been introduced by Irish Revenue to report certain tax free benefits and expenses paid in real time. This change is subject to a consultation period which has now started. Employers are encouraged to complete an Irish Revenue stakeholder survey by February 5, 2023.

The new reporting requirement is expected to go live on January 1, 2024. In preparation, employers should review current expense policies and processes and consider how data in relation to the tax free payments can be obtained in order to meet the real-time reporting obligations expected.

For more information in the enhanced reporting requirements, click here.

KPMG observations

Employers should review the new rules and be prepared if they are enacted by the Irish Revenue.

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United Kingdom: Amendments to the Enterprise Management Incentives (EMI) guidance

The HMRC updated the guidance on EMI, which is a tax-efficient employee share plan. The exercise to qualify underlying shares (EMI options) is exempted from income tax and social security, provided all the requirements are met at the time of grant and no disqualifying events take place before the exercise.

EMI plans often give boards the discretion to exercise options on specific circumstances to ensure commercial flexibility. With this flexibility, employees can take advantage of their options for certain situations that are not covered in the grant if in the board's opinion it is justifiable for the employee to exercise the option. HMRC acknowledges that the tax treatment won't be impacted if the board implements its discretion to exercise the use of EMI options in specific situations. However, in some circumstances, the use of these discretions may jeopardize the availability of tax advantages. These principles may also apply to tax-advantaged CSOPs.

The updates to the HMRC's guidance are aimed to clarify the impact of board discretion on tax-advantaged status of EMI options. The exercise of board discretion is to:

- Accelerate the extent that an option may be exercised (i.e., "vesting"), which should not impact its taxation, if the exercise date of the option is not brought forward
- Vary or waive a performance condition that should not impact the option's taxation, provided it is made on appropriate circumstances and on a reasonable basis (e.g., to allow a "good leaver" to exercise the EMI options at the board's discretion and hold onto the accrued tax advantages)
- Allow an option to be implemented at any given time and in any circumstances as determined by the board to result in the loss of EMI tax benefits as the shares received by the employee would not have been acquired through an EMI option (this should give the employee a right to acquire the shares).

Further, to avoid adverse tax consequences, the relevant board discretion needs to be provided when the relevant option was granted.

For more information, read our KPMG report.

KPMG observations

Employers are required to consider whether the historical exercises of EMI and CSOP options are in line with HMRC's position and to have a proper understanding of tax implications of any future use of discretion.

As per HMRC's new guidance, if employers have incorrectly operated PAYE and NIC, or employees through self-assessment have incorrectly accounted for tax, it may be possible to reclaim the specific amounts from HMRC within a given time limit. Employers are required to be fully aware about the tax implications that may arise on any use of board discretion related to EMI options before they are exercised.

United Kingdom: Amendments to tax-advantaged Company Share Option Plans (CSOP)

From April 6, 2023, as part of the U.K. Government's "Growth Plan," amendments will be introduced to closely align CSOPs an advantaged discretionary share option scheme, with flexible tax-advantaged EMI schemes available to qualifying growth companies.

In general scenarios, employees do not pay income tax or social security while exercising CSOP options after three or more years from the date of grant or on an

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"early" exercise of option. To implement a CSOP, the company should not be under the control of another company and meet certain conditions while granting the options.

The changes to the tax-advantaged CSOPs expected from April 6, 2023 include:

- Removal of the restriction related to granting of options from "open market shares" or "employee control" only
- For an individual employee, the maximum value of shares that can be subject to unexercised CSOP options will double from GBP 30,000 to GBP 60,000, as measured on the date of grant.

The above changes are expected to be welcomed by the companies, which are currently unable to implement CSOPs because of their multishare class structure.

For more information, read our KPMG report.

KPMG observations

If the CSOP arrangement is in place, companies must review the plan rules to assess whether it allows options to be awarded over shares up to the new financial limit, otherwise the plan rules should be amended to permit higher grants from April 6, 2023. Further, updates related to the plan documents will also be required.

With the new updates, CSOP will become an attractive follow-on incentive plan, as the tax advantages available are significant for both employer and employee. Companies are suggested to have a full review on whether this arrangement is suitable in 2022–23, given the relaxation in share requirements and the increase in plan limits.

Got a corp jet? If your company is US based or you have US employees (W-2 types) using the company jet, there is a wage inclusion amount required. Contact your KPMG representative for more details and assistance.

More from the Global Reward Services team

Data and analytics: Custom solution to cater to Total Rewards programs

As the complexities around compensation and rewards increases, so does the amount of data needed to administer your total rewards program. Clients often struggle to manage data collection, reconciliation and distribution on top of their other responsibilities. Talk to the U.S. GRS team about a custom solution to fit your needs, such as:

- Conversion of HR system data into vendor compatible format;
- Collation of data across vendors to support internal business needs and reconciliations;
- Reconciliation between HR system and vendor data to identify data discrepancies;
- Development of efficient and consistent data collection process with local teams or business units, leveraging vendor compatible formats and automation;
- Documentation of data owners and tracing of data lineage from point of origin to end user to allow for consistent and repeatable data collection and use across your organization.

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Health and Welfare: Innovative benefits program to improve employee retention and engagement

Global Reward Services published a white paper that explores how optimizing benefits programs can impact retention as well as employee performance and engagement. Key points from the white paper:

- Organizations are increasingly viewing their employees as "whole humans"—not just workers. Employers are recognizing that factors such as health, wellbeing, caring responsibilities, and more are all impacting the ability of employees to bring the best version of themselves to the workplace.[1]
- Factors such as rising employee expectations, the "Great Resignation," increasing social awareness, rise of hybrid working models, and an uncertain economic environment all contribute to the need for employers to differentiate themselves from competitors by offering a robust and innovative benefits package that meets the needs of their unique population.
- Not optimizing benefits offerings to retain top talent results in high costs related to attrition including loss of productivity, high recruiting expenses, and the need to pay above-market value to effect new talent. Specifically research suggests that direct replacement costs can add up to 1.5 to 2.times an employee's annual salary.[2]
- Many new solutions and strategies to target cost and improve the employee experience have developed over the last two to three years that employers may not be aware of. Many organizations are looking for data-driven and objective reviews of their program to ensure they are effectively managing their offerings.
- All organizations should be reassessing and strategically investing in their benefits package to ensure the benefits they're offering will attract the best talent.

Click here to read the white paper and learn more about how our team can help organizations reevaluate and redesign their benefits offerings to attract the best from today's workforce.

Global Equity Tracker: Tax rates – Flat, top, mean, or brackets

Did you know that the U.S. is the only country that has a flat supplemental wage tax rate for withholding taxes on equity? Other countries can have a different rate band for tax residents that should be used for withholding on equity. If you have employees that have worked from U.S. state to U.S. state, multistate withholding with tax credits or consideration for reciprocity helps avoid overwithholding tax.

If you are looking to be compliant for your equity program while also delivering as many shares or net cash to your employees, the tax rate used matters. Some countries do not have a refund mechanism, so if your company overwithholds the employee misses out on share appreciation because you withheld too many shares or never sees the cash because there is no way to obtain refunds by operation of local country law. Getting the tax rate spot on does matter, and don't forget regions and localities like U.S. states/cities, Canadian provinces, Swiss cantons, or Italian cities, to name a few.

Check in with our Global Reward Services team on how you can get your rates right for your equity program.

KPMG LINK Global Payroll Manager

Many companies struggle to manage the day-to-day intricacies of global payroll, particularly with respect to accurately reporting incentive compensation.

When used in conjunction with KPMG LINK Global Equity Tracker (GET), KPMG LINK Global Payroll Manager (GPM) streamlines the global payroll process by collecting the payroll tax calculation results data from GET and at the end of each payroll's pay period,

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[1] Looking for more: Employee expectations are on the rise (kpmg.us)

[2] What is the average employee turnover rate in 2022? – HelloTeam

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creates the applicable home and host payroll reports using each payroll's specific wage codes, files formats, currencies and language. Local payroll teams retrieve the payroll reports from GPM and can load the files directly into their local payroll systems. Once completed the payroll team can load the payroll post-processing results back into GPM, enabling the tool to perform an automated reconciliation process to help ensure that the payroll results match the GET instructions, highlighting discrepancies where identified.

Together, GET and GPM allow an organization to drive effective execution at the local levels and sustain a cohesive process for all stakeholders, helping to ensure increased compliance and a positive employee experience where local payroll aligns with incentive compensation awards received.

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