Global Reward Services Quarterly Newsletter

September 2021

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

Topics included in this issue:

Africa

South Africa: New process to support breaking tax residency

On June 3, the South African Revenue Service (SARS) introduced new requirements regarding the documentation required to support that an individual has broken tax residence from South Africa. This update will be applicable for tax returns filed for the year ended February 28, 2021 onwards.

South African residents are subject to tax on their worldwide income (subject to certain exemptions) and worldwide capital gains. A nonresident is only liable for tax in South Africa on income derived from a source within South Africa and capital gains arising from the disposal of immovable property or any interest or right to immovable property situated in South Africa.

The Tax Residence Tests review if the individual would be considered "ordinarily resident" in South Africa; or whether the physical presence test is met (this typically applies to inbound foreign nationals). In addition, an assessment of the Double Tax Agreement between the two countries must be done to determine whether this impacts a person's South African tax residence.

Effective from the 2017 tax year, taxpayers were required to declare a change in tax residence status on their relevant annual income tax return. The update now mandates that taxpayers submit a "Declaration of Cease to be a Tax Resident" along with the annual tax return, or to a dedicated SARS mailbox to notify the tax authority that the individual has ceased tax residency. There are a number of additional documents required to be included with this, as stipulated on the SARS website.

Read the KPMG report.

KPMG observations:

Residency plays a major role in basis for taxation in South Africa. For individuals who are not ordinarily residents of South Africa, employers and employees must review on an annual basis if they will be considered tax resident of South Africa. If it is identified that a taxpayer desires to cease their tax residency, they must submit a signed declaration form, a letter of motivation, and a copy of the taxpayer's travel history. These individuals must present facts and circumstances which support their cessation of tax residency, and in most cases, they must refer to their tax resident position in another country.

KPMG expects that taxpayers and employers may need assistance with making residency determinations, and thus determining taxes owed, under the new rules in South Africa. Employers with global mobility interests in South Africa need to be alert to the new process and procedures for determining tax-residency. Previously, declaring a tax residence change in South Africa was performed by a simple election on income tax returns. Going forward, companies must have detailed understanding of their South Africa employees' residency statuses and the subsequent withholding requirements.

Americas

Canada: The Canadian Revenue Agency's new "hybrid methodology" for Cross-Border RSUs

The Canadian Revenue Agency (CRA) has detailed a new "hybrid methodology" used in determining Canadian sourcing and taxation of cross-border restricted stock units (RSUs). If an employee performs services in Canada and another jurisdiction, then the hybrid methodology should be used to source RSU-related income between Canada and the other jurisdiction(s).

Previously, the CRA position was to source gains based on the days of employment in each jurisdiction during the vesting period of an award. Under the new hybrid methodology, the fair market value of underlying shares at grant is separated as "in the money" (ITM) gain related to past services. This hybrid methodology requires RSU related income to be split between the ITM portion at the date of grant, and the portion that accrues from grant to vest. It is the view of the CRA that the ITM portion of awards is related to past services and should be sourced to the jurisdictions in which the employee performed services in the year of grant.

The new position relates to RSUs granted after 2020. Affected awards and taxation are subject to provisions of any tax treaties between Canada and the other applicable jurisdiction(s). The CRA states that its position on taxation of RSUs is "in part" informed by Organisation for Economic Co-operation and Development guidance.

Read the KPMG Flash Alert.

KPMG observations:

The CRA's views under this new technical interpretation are contradictory to its previous position on sourcing mobile employees' RSUs. As employers grant equity awards to their workforce going forward, sourcing practices for withholding at vest will need to be adjusted. The new guidance presents the risk of sourcing disparities between company protocols and CRA requirements. To prevent sourcing uncertainties and clearly define which portion of a share award is related to services previously performed, employers should be clear in identifying the period of services to which RSU grants directly relate.

Canada: New stock option regime in effect

As of July 1, new limits on favorable employee stock option tax rules are in place in Canada. The Canadian federal budget bill, Bill C-30, places a new annual maximum on stock option compensation eligible for the employee 50 percent deduction. Options with underlying share fair market values in excess of $200,000 will now be considered "nonqualified securities" and are ineligible for a 50 percent deduction upon exercise. In determining fair market value for purposes of the 50 percent deduction, the underlying shares are to be valued as of the date of the option agreement. Although this rule limits the employee's tax deduction, employers are provided the opportunity for a new deduction equal to the taxable benefit realized by an employee upon exercise of nonqualified options. The newly announced guidelines do not affect options granted by Canadian-controlled *private* corporations or corporations with annual revenues equal to $500 million or less.

The new limits and deduction rules apply to option agreements made on or after July 1.

Read the KPMG report.

KPMG observations:

The new Canadian deduction rules presented in Bill C-30 have the greatest impact on taxpayers who have been granted options as part of their compensation, as significant limits have been placed on tax deduction potential. However, there are also new responsibilities of granting employers related to these rules. For options granted on or following July 1, 2021, employers, unless excluded by private status or revenue threshold, must explicitly inform employees which of their option awards are based on nonqualified shares. Employers must notify option recipients of nonqualified status within 30 days of an option agreement.

As these new requirements divide an employee's options into qualified and nonqualified portions, employers must keep detailed records of an employee's option compensation over time. To ensure that withholding, employee exclusions, new corporate deductions, and other vital amounts are calculated correctly, companies should closely examine the amounts and timing of their option grants going forward.

United States: The Internal Revenue Service's competent authority arrangement between the U.S. and Switzerland

On June 7, the U.S. Internal Revenue Service (IRS) published a competent authority arrangement (CAA) between U.S. and Swiss authorities that identifies the scope of pensions and other retirement plans that qualify for benefits under the "dividends" clause of the U.S.-Switzerland income tax treaty (the Treaty). The Treaty was amended by a protocol, which was signed in 2009 but became effective for most purposes on January 1, 2020. This 2009 protocol expanded the scope of the dividends article of the Treaty so that it now applies not only to dividends paid to pension and other retirement arrangements, but also to dividends paid to individual retirement savings plans. Thus, for example, a U.S. individual retirement account (IRA) or Roth IRA that invests in a Swiss company can now receive dividends from that company without the imposition of Swiss income tax.

The CAA provides details on which pension plans and other retirement arrangements, including individual retirement savings plans, in each country qualify for these treaty benefits. The primary plans indicated are U.S. 401(k) plans, U.S. IRA plans, Swiss pension or other retirement arrangements, and Swiss individual retirement savings plans that are qualified under specific guidance.

The CAA further states that the above list is not exclusive and that other pension arrangements and individual retirement savings plans may apply to the competent authorities of the respective countries to determine if they qualify for the benefits of article 3, paragraph 10 of the treaty. Upon signature by the U.S. and Swiss competent authorities, the CAA applies to dividends paid on or after January 1, 2020 and supersedes earlier guidance on this issue as provided for under previous IRS announcements.

For more information, read our KPMG report.

KPMG observations:

KPMG notes that the CAA addresses the issue of which pension arrangements and retirement plans qualify for the exemption from source-country tax on dividend distributions under paragraph 3 of article 10 of the Treaty. However, in a finding which is of note to mobility functions, the agreement does not directly address which plans allow for individuals working in one of the two countries to deduct or exclude their contributions to a retirement arrangement established in the other country. The CAA does not explicitly state that pension plans and other retirement plans qualifying under the aforementioned article 10, paragraph 3 of the treaty allow tax exemptions for individuals working in the U.S. but holding retirement accounts in Switzerland.

Asia/Pacific

Australia: Employee Share Scheme tax and regulatory reforms

In late July, the Australian Department of the Treasury released draft legislation to action changes to Employee Share Scheme (ESS) tax and regulatory requirements. The ESS reforms were initially announced in the FY22 Australian Federal Budget.

The proposed reforms will simplify current ESS requirements and make it easier for both listed and **unlisted** companies to grant equity to Australian employees. In particular, the proposed changes impact unlisted companies' opportunities to grant equity by raising the cap on total equity offers that require employee monetary contribution to acquire ESS interests to AU$30,000, and removing the cap altogether for offers that do not require employee monetary contribution (other than for contractors). Currently, a cap of AU$5,000 applies to the value of equity that an unlisted company may grant to an Australian employee in a 12-month period. There are limited exemption opportunities available to unlisted companies under the current regime.

The proposed reforms will also:

— Remove the current requirement for a listed company's shares to have been traded for at least three months prior to making an employee share scheme offer

— Remove termination of employment as a point of taxation on future grants of awards for share schemes in Australia.

The proposed changes have been widely supported by Australian business and industry groups. Consultation on the draft legislation has now closed and draft legislation is expected to be tabled in Parliament in the coming months.

KPMG observations:

The legislation that is proposed to raise limits on unlisted companies' ESS offerings presents more sizable equity reward opportunities to these employers. The existing AU$5,000 cap on ESS equity offered in a 12-month period has been viewed as rather restrictive.

The KPMG Australian Rewards team welcomes the proposed reforms, which are intended to streamline the restrictive regulatory framework that currently applies to ESS awards and deters (particularly unlisted) companies from offering ESS incentives in Australia.

Hong Kong: The Hong Kong Court of First Instance ruling on restricted stock

On June 29, 2021, the Hong Kong Court of First Instance (CFI) ruled that restricted stock released in accordance with a termination agreement should not be subject to Salaries Tax.

A taxpayer in Hong Kong had been employed by a bank and received restricted share awards (RSAs) carrying a three-year vesting period as part of his annual variable compensation. The taxpayer's employment by the bank was terminated in 2013. Under the share plan, vesting was permitted following termination as a "good leaver," subject to the terms of a termination agreement. Following termination, the taxpayer had two grants vest, in 2014 and 2015. The Inland Revenue Department assessed Salaries Tax on these amounts, which the taxpayer subsequently appealed. Initially, the CFI dismissed the taxpayer's appeal to hear the case, being of the view that the post-termination vests could not be reasonably argued as nontaxable. However, the taxpayer was successful upon appeal and the CFI being required to re-examine the case ultimately determined the vesting events to be nontaxable.

Fresh consideration included in the Termination Agreement identified the purpose for the release of the 2012 shares, which was to procure the taxpayer to provide long-term assistance in the bank's litigation. The CFI decided that the release of the 2012 shares was not subject to Salaries Tax as, rather than being employment income, it was "from something else."

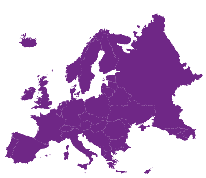
Read the KPMG Flash Alert.

KPMG observations:

As demonstrated by the CFI's shifting position in this case, KPMG expects the taxation of share-based awards in termination scenarios to continue to be a contentious and disputed matter in Hong Kong.

KPMG China, the KPMG International member firm acting in Hong Kong, regularly deals with organizations planning for and implementing employee terminations. KPMG has represented numerous taxpayers in tax-related disputes. Employers often have need for assistance in planning for redundancies and terminations, and Salaries Tax disputes represent one of many added challenges in these scenarios.

Europe



Finland: Draft proposal published on the economic employer concept

On July 1, the Finnish government published a draft proposal introducing the economic employer concept, which would expand Finland's availability to tax income paid for services to a Finnish employer.

Under the current position, Finland's right to tax income paid by a foreign employer is limited by particular requirements, including a physical presence test and employer establishment in Finland. This economic employer proposal expands the range of income considered taxable in Finland.

The proposal characterizes the economic employer as the company that has control over the employee's work, regardless of where their salary is paid from. New guidelines concern situations in which an employee is formally employed by a foreign entity and compensation is paid by the foreign entity. The economic employer concept would establish that the employee is liable to tax in Finland if the economic employer is regarded to be in Finland. If the proposed policies are enacted, then the Finnish economic employer and the foreign employer will both have Finnish reporting obligations. The proposed policies are expected to be enacted in early 2022.

Read the KPMG Flash Alert.

KPMG observations:

KPMG notes that the proposed Finnish economic employer rule is similar to policies implemented in other countries recently. Namely, Sweden introduced the concept in early 2021.

It is vital that employers consider all cases where their work force is linked to Finland and may lead to reporting and taxation under economic employer rules. International assignments linked to Finland as well as services associated with a Finland-based company should be under close review.

Ireland: Irish Revenue issues two e-briefs on ESA

Irish Revenue has issued two e-briefs related to the new Employer's Share Award (ESA) return to be completed by employers and submitted to revenue officials.

In e-brief no. 123/21, Revenue disclosed the new ESA to be completed by employers. The form outlines information related to unapproved share award schemes which are required to be disclosed for company employees and directors. Furthermore, cash payments deriving value from underlying share awards must also be included in ESA forms. The ESA form calls for a wide scope of share plans to be reported, including restricted stock units, employee share purchase plans, stock appreciation rights, cash-settled awards, and several others.

Additionally, the e-briefs confirmed August 31, 2021 as the filing deadline for 2020 ESA returns. The filing deadline for subsequent years will be March 31 of the year following. Filing is mandatory, and failure to file could result in monetary penalties to employers.

Read the KPMG report.

KPMG observations:

With the exception of share award related transactions, there were no explicit arrangements for employers to report unapproved equity compensation transactions prior to these publications.

Employers who deliver equity-based awards in Ireland should review their existing share plans and cash-based incentives to assess the related taxation and reporting obligations. It is vital that employers identify the internal functions and stakeholders that will be responsible for gathering and providing information newly required in ESA returns.

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