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Legislative update: Compensation and benefits-related provisions in COVID relief bill

The U.S. House of Representatives today approved the Senate amendment to H.R. 1319, the "American Rescue Plan Act of 2021" (Rescue Act)—thus, completing congressional action on the legislation.

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The Rescue Act includes several compensation benefit-related provisions, such as 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

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 an additional "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.

KPMG observation

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.

KPMG observation

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.

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 contains a new provision for 2020 startups—referred to as a "recovery startup business"—established after February 15, 2020, and annual gross receipts are limited to $1 million. A recovery startup business meets the ERC eligibility test even if it does not otherwise meet the general eligible employer ERC requirements (suspension by government order, reduction in gross receipts, etc.). However, the amount of credit is limited to $50,000 per quarter under this provision.

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% 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 startup businesses and 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 vaccination or leave for recovering from a COVID vaccination.

Dependent care exclusion increased for 2021

For 2021, the Rescue Act increases the amount that can be excluded from income under section 129 for employer-provided dependent care up to $10,500 (increased from $5,000) for married taxpayers and up to $5,250 (from $2,500) for single taxpayer filers.

Pension plans

The Rescue Act includes a variety of provisions related to pensions plans with many aimed at multi-employer pension plans, which have been historically underfunded. Many of the provisions for both multi-employer and single-employer plans involve changes to actuarial calculations.

New provisions included in the Rescue Act to assist multi-employer pension plans include:

- A temporary delay of the designation of a plan as endangered, critical, or critical and declining status for the first plan year during the period beginning March 1, 2020, and ending February 28, 2021. The plan's funding status will be the same as the status for the preceding plan year
- A temporary five-year extension of the funding improvement period or rehabilitation period if the plan sponsor is endangered or in critical status for plan years beginning in 2020 or 2021
- Financial assistance fund established under the Pension Benefit Guaranty Corporation (PBGC) for financially troubled plans

Provisions in the Rescue Act to address single-employer pension plans include measures that:

- Extend the shortfall amortization to 15 years (extended from seven years)
- Extend the pension funding stabilization percentages

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