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TAX NOTE

December 1, 2020

Revised Stock Option Rules Released

As promised in the Throne Speech, the Government of Canada released a Notice of Ways and Means Motion as part of its Fall Economic Statement on November 30, 2020, which includes detailed legislative proposals relating to the employee stock option deduction.

The revised legislation is broadly similar to the draft legislation that was released in June, 2019, although there are some important changes, as noted below.

As with the initial proposals, the draft legislation proposes to limit availability of the one-half deduction for employee stock option gains if the value of shares granted under options exceeds $200,000 per vesting year. For example, if an employee receives options, exercisable immediately, to acquire 200,000 shares for $1.00 per share at a time when they are worth $1.00 per share, the new rules do not apply no matter how much the shares go up in value. However, if an employee receives options to acquire 201,000 shares for $1.00 per share, the ultimate benefit relating to 1,000 of those options generally will be fully taxed under the new rules unless an exception applies. In practice, the rules will be more complex than they appear in concept due to various issues concerning vesting conditions and timing, notice requirements, exercises, multiple employers, cross border arrangements and other considerations.

To the extent an employee is denied access to the stock option deduction relating to a stock option benefit, the employer generally is permitted a corresponding deduction in computing its taxable income, provided a notice requirement is satisfied.

The initial 2019 proposals contemplated drawing a line between "large, long-established, mature firms", on the one hand, and "start-ups and rapidly growing Canadian businesses" on the other hand. At the time, it was not clear how that line would be drawn and the Joint Committee on Taxation of the Canadian Bar Association and CPA Canada recommended that it should be based on readily determinable and clear rules.

The new proposals seem to have followed that recommendation, along with most other recommendations of the committee. The rules now provide that all Canadian-controlled private corporation employers are exempt. As well, all other employers are exempt if financial statement revenue (or consolidated group revenue if applicable) for the latest fiscal year is $500 million or less.
The new rules apply to options granted on or after July 1, 2021.

Please contact us if you would like to discuss how the new measures may affect your organization's compensation strategies.