

# Mobility: tax alert

June 2019

## Canada

### Update on proposed changes to employee stock option rules

#### Executive summary

On 17 June 2019, Canadian Finance Minister Bill Morneau tabled a Notice of Ways and Means Motion (NWMM) that contains proposed changes to the tax treatment of employee stock options that were announced in the 19 March 2019 federal budget.

The proposals include a CA\$200,000<sup>1</sup> annual limit on employee stock option grants that can receive the tax-preferred treatment available under the current employee stock option rules.

According to the Department of Finance (Finance), the intention of the new rules is to restrict the preferential treatment for employees of large, long-established, mature firms and provide for a full stock option deduction for stock option benefits granted by "[start-ups and emerging Canadian businesses](#)."

In addition, stakeholders are invited to provide input on the characteristics of companies that should be considered start-ups, emerging and scale-up under the new rules by 16 September 2019.

#### Key points

- ▶ **Effective date:** The changes will apply to all stock options granted on or after 1 January 2020. Options granted (regardless of vesting or exercise) prior to 1 January 2020 will be subject to the currently enacted legislation.

- ▶ **Canadian-controlled private corporations (CCPCs):** Options granted by CCPCs are not impacted by these changes.
- ▶ **The \$200,000 limit on stock options** that vest in any calendar year is based upon the value of the shares at the time of grant. This concept has some similarities to the Incentive Stock Option regime in the United States. See EY HR and tax alert, [Canada's Federal budget 2019/20 proposes changes to stock option deduction](#), issued April 2019.
- ▶ The terms "**start-ups**," "**emerging**" and "**scale-up**" **Canadian businesses** are not defined in the NWMM. As expected, these terms have proved difficult to define and, accordingly, Finance has announced that there will be a consultation process. Finance stated that some non-CCPCs could be start-ups, emerging or scale-up companies, and those non-CCPCs that meet certain prescribed conditions will also not be subject to the new rules. The Government is consulting Canadians on what the prescribed conditions should be for this purpose. Once these terms are defined, they will be prescribed in regulations to the *Income Tax Act* (Canada).

Stakeholders are invited to provide input to Finance by 16 September 2019.

- ▶ **Employer deduction:** The employer may be able to claim a deduction on the portion of the benefit that does not qualify for the 50% stock option deduction as a result of the \$200,000 limit. This corporate deduction will only be available if the stock options would have otherwise qualified for the 50% deduction. The ability to claim a deduction will not apply to employers that are CCPCs or companies that meet prescribed conditions (i.e., “start-ups”, “emerging” and “scale-up” Canadian businesses once these terms are defined).

Companies issuing stock options to employees will be able to designate all options as “non-qualifying securities” (and potentially fully eligible for a corporate deduction). This designation is made on a grant by grant basis. If this designation is made, the employee is required to be notified at the time of grant, and the employee will not be entitled to the 50% deduction on any portion of the grant.

In certain cases, foreign parent companies grant options to employees of a Canadian subsidiary, with costs recharged to the Canadian subsidiary. The manner in which the proposals are drafted suggests that a corporate deduction may only be available where a corporation granting the options is the employer. If the provisions remain as drafted, the availability of the corporate deduction could be significantly reduced.

- ▶ **Notification and tracking:** Employers will need to ensure compliance with respect to the \$200,000 limit. Employers will need to notify their employees in writing when options are granted that are subject to the new rules, as well as notifying the Canada Revenue Agency when securities subject to the new rules are issued. Accordingly, companies will need to have processes in place to determine and track which options are subject to tax under the existing and new rules. This will impact payroll withholding/reporting requirements and the availability of a corporate deduction.

### Implications

Companies may want to consider accelerating the grant of options if they are at risk of having the new rules apply to options granted after 31 December 2019.

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<sup>1</sup> Currency references in this Alert are to CA\$.

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