

Fall Economic Statement 2020: Stock Option Deduction

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Under the *Income Tax Act* (Canada), when an employee exercises a stock option to acquire shares, the difference between the value of the shares at the time the option is exercised, and the amount paid by the employee to acquire the shares is treated as a taxable employment benefit. The employee may be entitled to claim a deduction equal to one-half of the taxable benefit, provided certain conditions are met.

In Budget 2019, the federal government announced its intention to limit the employee stock option deduction for high-income individuals employed at large, long-established, mature firms by proposing an annual limit of \$200,000 on stock options that would be eligible for the deduction. The government released draft legislative proposals in June 2019 and consulted stakeholders on the characteristics of companies that should be considered start-up, emerging and scale-up corporations to exempt such corporations from the new proposals.

On November 30, 2020, the government released Fall Economic Statement 2020, and, based on the June 2019 proposals and the input received from stakeholders, proposed the following changes to the employee stock option rules.

New Tax Rules

Under the new rules, a \$200,000 limit will apply on the amount of employee stock options that may vest in an employee in a calendar year and still qualify for the stock option deduction. The limit will be based on the fair market value of the shares underlying the options at the time the options are granted. An option vests when it first becomes exercisable and the determination of when an option vests is made at the time the option is granted. If the year in which the option vests is not clear, it will be considered to vest on a pro-rata basis over the term of the agreement, up to a five-year period.

Employee Tax Treatment

Where an employee exercises a stock option in excess of the \$200,000 annual limit, the full amount of the taxable employment benefit will be included in the employee's income in the year in which the option is exercised and the employee will not be entitled to the stock option deduction in respect of the benefit.

Employer Tax Treatment

The new stock option rules will apply to employers that are corporations or mutual fund trusts. Employee stock options granted by a Canadian-controlled private corporation (CCPC) will not be subject to the new limit. Non-CCPC employers with annual gross revenues of \$500 million or less will also not be subject to the new limit.

The employer will be entitled to a deduction for the taxable benefit included in the employee's income in respect of a stock option in excess of the \$200,000 limit. Employers subject to the new rules can choose whether to grant stock options under the existing rules, up to the \$200,000 annual limit per employee (and ensure compliance with the limit), or grant stock options under the new rules, which would not be eligible for the employee deduction but would be eligible for a deduction for corporate income tax purposes. The employer will be required to notify its employees and the Canada Revenue Agency if the options are subject to the new rules.

Coming into Force

The new rules will apply to employee stock options granted after June 2021. The existing rules will continue to apply to options granted before July 2021, including qualifying options granted after June 2021 that replace options granted before July 2021.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.