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## Canadian tax alert

### The CRA provides clarification on compensation plans

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At the Canada Revenue Agency (CRA) Roundtable session of the 2015 Canadian Tax Foundation's annual conference, CRA representatives clarified and provided updates on a variety of issues, including the CRA's views on the application of the salary deferral arrangement (SDA) rules to various programs.

The SDA rules can accelerate the taxation of individuals who participate in plans under which the payment of salary or other remuneration is deferred to a subsequent year. A number of plans are exempted from the SDA rules. In order to avoid accelerated employee taxation, employers have been careful to structure programs to meet these exemptions. The comments provided by the CRA publicized its position on certain commonly used programs.

#### Phantom stock retirement plans

Phantom stock retirement plans, commonly referred to as deferred share unit (DSU) plans, are structured to provide lump sum payments based on the value of the employer's shares when the participant retires, is terminated or dies. Such plans are very popular and are frequently incorporated into senior executive and director remuneration. They are exempted from the SDA provisions provided certain restrictions set out in the Income Tax Regulations are satisfied.

Where a plan participant's remuneration is subject to both US and Canadian taxation, complexities may arise. In those situations, the plan must also comply with the requirements set out in section 409A of the Internal Revenue Code in order to avoid accelerated US taxation of the plan participant. Unfortunately, the Canadian and the US requirements are not necessarily identical. The CRA confirmed:

Consequently, it is our view that a DSU plan could not provide for the full range of distribution events permitted by section 409A with respect to participants who are subject to both Canadian and U.S. taxation, and still comply with paragraph 6801(d).

The CRA stated that where a ruling was obtained in respect of a DSU with the broad section 409A language, the SDA provisions will not apply to units granted in advance of the revocation of the ruling. However, such rulings are being reviewed with a view towards their revocation. Where a published ruling was relied upon in structuring a DSU plan, the SDA rules will not apply to units credited on or before November 24, 2015.

While DSU plans cannot offer a broad range of distribution alternatives, it is possible to structure such plans and the relevant documentation to satisfy the exemption requirements of both US section 409A and the Canadian Income Tax Regulations. We recommend that plans be reviewed to ensure that they contain the proper level of detail and, where necessary, are revised to ensure that the recipients of future awards pay no tax until the benefits are distributed.

### Convertible bonus plans

In addition to DSU plans, bonus plans under which benefits are distributed by the end of the third calendar year following the year in which the services that gave rise to the bonus were rendered are also exempted from the SDA rules.

The CRA has granted rulings allowing the conversion of such deferred bonus units to DSU units on a tax-deferred basis, indicating that such plans would satisfy the exemption to the SDA provisions. However, upon further consideration, the CRA has changed its position and has indicated that such convertible units will not satisfy the SDA exemptions. Rulings permitting exemption from the SDA rules will be revoked.

Where a ruling was granted in respect of a convertible bonus plan, the SDA provisions will not apply to units granted in advance of the revocation of the ruling. Where a published ruling was relied upon in structuring a convertible plan, the SDA rules will not apply to units credited on or before November 24, 2015.

Employers with such plans in place should note that the conversion feature should be stripped from the future awards. If the employer wishes to allow plan participants to choose the duration of the deferral, that election must be made prior to the date on which the award is made.

*Anne Montgomery and Peter Megoudis, Toronto*

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