



Global Employer Services

## Canadian tax alert

### Delayed implementation of proposal to introduce an annual cap on beneficial stock options treatment

January 14, 2020

On December 19, 2019, the Canadian government announced that the proposed changes to the taxation of stock options would not come into force on January 1, 2020, as originally planned.

#### Background

For many years, stock options have attracted preferential tax treatment in Canada, provided certain conditions are met. Individuals have been able to claim a deduction equal to 50% of the option gain at exercise, effectively

#### Contacts:

**Guy Jason**

National Leader  
Tel: 613-751-6674

#### Quebec

**Chantal Baril**

Tel: 514-393-6507

**Patrick Bonneau**

Tel: 514-393-6262

**Amélie Desrochers**

Tel: 514-393-5554

leading to stock options being taxed at a rate equal to one half of the normal personal tax rate (the same rate that is applicable to capital gains).

Following Budget 2016, the Canadian government committed to reviewing federal tax expenditures and the fairness of Canada's tax system, including stock option benefits.

## **Budget 2019 proposal**

As previously communicated in our [April 17, 2019 Canadian tax alert](#), the federal government announced its plan to limit the current 50% stock option deduction for high-income individuals employed at large, long-established, mature firms by introducing an annual CA\$200,000 cap on employee stock option deductions. This limit is intended to make the regime more equitable for Canadians, while ensuring that start-ups and emerging Canadian businesses that are creating jobs maintain the ability to use employee stock options as an effective tool to attract and reward employees, and to accelerate their growth in a tax-efficient manner.

## **Draft legislative proposals released June 17, 2019**

Further details were announced when the federal government released draft legislation on June 17, 2019. Highlights of the draft legislation are as follows:

- A CA\$200,000 annual cap on employee stock option grants that may receive tax-preferred treatment (applicable for each vesting year and based on fair market value of underlying shares at grant) is introduced;
- The new limit will not apply to stock options granted by Canadian-controlled private corporations (CCPCs) and some non-CCPCs, such as start-ups, emerging and scale-up companies that meet prescribed conditions; and
- Employers will be able to claim a corporate tax deduction for the non-qualifying options.

The government held a consultation period until September 16, 2019, during which comments were provided on the draft legislation in general and also specifically on the characteristics of companies that should be considered "start-up, emerging, or scale-up companies" for purposes of determining the conditions that will be prescribed in the regulations.

## **Implementation delay**

The June 17, 2019 legislation was scheduled to come into force on January 1, 2020, and apply to stock options granted on or after that date. However, on December 19, 2019, the government announced that the proposed changes would not come into force as of that date.

**Terri Spadorcia**  
Tel: 514-393-5138

**Eastern Region**  
**Scott Elms**  
Tel: 905-315-6773

**Toronto**  
**Sean McGroarty**  
Tel: 416-601-6128

**Habib Meghjee**  
Tel: 416-601-6273

**Western Region**  
**Bill Fridfinnson**  
Tel: 403-261-8159

**Maria Tsatas**  
Tel: 514-393-5220

**British Columbia**  
**Christina Diles**  
Tel: 604-640-3003

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The government indicated that it will provide details on how it intends to move forward with the stock option measures in the 2020 budget, which is expected to be tabled in Parliament at some time in the February-March period. Further, the new coming-into-force date will provide sufficient time to individuals and businesses to review and adjust to the new rules.

The minister of finance of Quebec has stated that it is currently reviewing Quebec's stock option legislation and will announce its position at a later date. The Quebec legislation currently provides for a stock option deduction of 25% or 50% on qualifying options for Quebec taxpayers.

This announcement postponing the implementation of changes to the stock option regime comes as a relief to taxpayers, given the ambiguity around categorizing certain companies as start-ups or emerging Canadian businesses, and the complexity for employers to implement processes to properly track stock option grants with different tax attributes over different vesting periods.

This delay indicates that the federal government is carefully reviewing the input received during the consultation period and wants to ensure that the amendments meet its key objectives. Our [comments on the draft legislative proposals](#) identify important technical and administrative issues that will need to be addressed and clarified.

If the proposals in the 2020 budget contain no material changes from the original proposals, the majority of employees receiving employee stock option benefits may be unaffected. However, companies should carefully consider the changes, i.e., whether future grants of stock options to executives and high-earning employees could be subject to the limitation on preferential treatment under the new rules. Alternatives to issuing stock options to these individuals and a broader review of a company's executive compensation framework should be considered.

On the other hand, it is welcome news for employers that a corporate tax deduction will be available for any options not qualifying for the preferential income tax treatment.

Deloitte LLP  
Bay Adelaide Centre, East Tower  
8 Adelaide Street West, Suite 200  
Toronto ON M5H 0A9  
Canada

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