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**Global Rewards Updates:  
Canadian budget proposal to introduce a CA\$200,000 annual cap on beneficial treatment of employee stock options for large companies**

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

Following Budget 2016, the Canadian government committed to reviewing federal tax expenditures and the fairness of Canada’s tax system. Statistics have shown that the tax benefits of the employee stock option deduction disproportionately accrue to a very small number of high income individuals employed at large, long-established, mature firms. The Canadian government is looking to address this and make the stock option tax regime more fair and equitable for Canadians while ensuring start-ups and emerging Canadian businesses can continue to grow and expand.

## Budget 2019 proposal

On March 19, 2019, the federal government announced its plan to limit the current stock option deduction of 50% for high income individuals employed at large, long-established, mature firms. The proposals are as follows:

- Introduce a CA\$200,000 annual cap on employee stock option grants that may receive tax preferred treatment (based on fair market value of underlying shares at grant); and
- Permit employers a corporate tax deduction for the nonqualifying options.

For start-ups and rapidly growing Canadian businesses, employee stock option benefits would remain uncapped. As such, start-ups and emerging Canadian businesses will maintain the ability to use employee stock options as an effective tool to attract and reward employees and be able to accelerate their growth in a tax efficient manner.

It is not yet known what the criteria for defining large, long established, mature firms will include.

## Example

- Henry is an executive at large, mature firm and is granted stock options to acquire 100,000 shares at CA\$50 per share (the fair market value on the date of grant).
- Total fair market value at grant of CA\$5,000,000 > CA\$200,000 cap.
- Since the fair market value of the stock options on the date of grant exceeds CA\$200,000 limit, the stock option benefit will be limited:
  - Only 4,000 stock options (CA\$200,000 ÷ CA\$50) will benefit from preferential treatment and the rest will be subject to full taxation at ordinary tax rates when they are exercised.
  - If, at exercise, fair market value of the shares is CA\$70/share, then under the proposed regime, only CA\$80,000 of the CA\$2,000,000 employment benefit will be eligible for the preferential regime. Henry will pay tax on the CA\$1,920,000 employment benefit at ordinary rates and on the CA\$80,000 at (effectively) one half of ordinary rates.

Further details of this measure are expected to be released before the summer of 2019, including details on the conditions and criteria for companies that are subject to the deduction limit. Any changes would apply on a go-forward basis only and would not apply to employee stock options granted prior to the announcement of legislative proposals to implement the new regime.

## Deloitte's view

If the proposal is adopted by the Canadian government, the vast majority of employees that may receive employee stock option benefits would be unaffected. However, companies should consider the new possibilities from the proposition carefully, *i.e.*, whether future grants of stock options to executives and high-earning employees could be subject to the limitation of preferential treatment under the new rules. It is also welcome news for employers that a corporate tax deduction will be available for any options not qualifying for the deduction.

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