

Global Employer Services (GES)

Global Rewards Update: Canada — Stock-Settled Awards

May 2013

Employer Deduction for Stock-Settled Awards

Under Canadian tax law, a corporate income tax deduction is not permitted when an employer agrees to sell or issue treasury or newly issued securities to employees. When an employer has the discretion to settle the award in either stock or cash, the issue becomes whether an agreement to issue stock was in effect at the time the employer decided to settle the award in shares, thus eliminating the corporate income tax deduction.

The long-standing position of the Canada Revenue Agency (CRA) is that when an employer elects to settle an award in stock, an agreement to issue securities arises at that point, and a corporate income tax deduction will therefore be denied. This position was recently rejected in the case of *Transalta Corp. v. R* [2012] 3 C.T.C. 2186, (the “*Transalta case*”).

Impact of the *Transalta Case*

In the *Transalta case*, the tax court of Canada ruled that the employer was entitled to claim a corporate income tax deduction for the fair market value of the stock issued under a deferred bonus plan if the employer retained the unilateral discretion to distribute cash or issue stock. The Canadian tax authorities have indicated that they will not appeal the case, but that its application will be restricted to similar situations.

While the *Transalta case* confirms the employer’s ability to claim a corporate income tax deduction if the employer retains the unilateral discretion to distribute cash or issue stock to settle an award, employers should be aware that certain restrictions apply even in this situation:

- The fair market value of the shares issued to employees under these arrangements will be taxed at the recipient’s marginal tax rate rather than the preferential tax rate available for certain stock option benefits.
- The Canadian tax provisions regarding salary deferral arrangements, which can result in accelerated taxation of employees, restricts the design of these types of plans. In general, tax acceleration rules can apply when the payment of an employee’s salary is deferred beyond the end of the year in which employment services were rendered, unless the plan satisfies certain exemptions. Subject to certain stringent requirements, deferred bonus programs may be suitable plans to which the decision of the court in the *Transalta case* can be applied.
- Income taxes, and in some situations, social security taxes, must be collected when the shares are issued. Ideally, there will be a market on which sufficient shares can be sold to satisfy the withholding

tax obligations. However, the employer must anticipate this withholding obligation and establish a tax collection mechanism.

Action

- Companies should review their existing incentive programs to determine if they currently operate a deferred bonus plan for employees of their Canadian operations to which this case might apply.
- Companies should consider the accounting and legal implications of establishing a deferred bonus plan under which the employer retains the unilateral discretion to distribute cash or issue stock to settle awards.

People to contact

For assistance with this matter, or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services adviser or email us at globalequity@deloitte.com and a global rewards consultant will contact you.

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