Global Employer Services | 10 November 2015

Global Rewards Update

Canada – Proposed limitations to the stock option deduction

Background

The newly elected Liberal government in Canada included in its electoral campaign proposals to reduce tax benefits by limiting the availability of the stock option deduction. It has yet to be seen how this promise will translate into legislative reality, however timely actions may help mitigate any adverse consequences.

Current rules

When an employee exercises a stock option, a taxable benefit equal to the difference between the fair market value of the share and the exercise price arises.

Under current Canadian legislation, an employee may claim a deduction equal to 50% of the taxable benefit, provided certain conditions are met (namely that the share is a common share and the exercise price paid is not less than the fair market value of the share when the option was granted).

This deduction allows many employees to enjoy the equivalent to capital gains treatment from a tax perspective on potentially large sums of compensation.

Potential changes

The new Liberal government stated in its electoral campaign that it would look for opportunities to reduce tax benefits that substantially benefit individuals earning in excess of CAD 200,000 annually.

It stated that a starting point for this review would be to cap the deduction which an employee can claim when exercising stock options. It is expected that legislation will be introduced to limit the deduction so that it only can only be claimed in respect of stock option benefits not exceeding CAD 100,000 annually.

It is not clear at this stage what the effective date for any proposed changes may be (for example, whether the changes will apply to any options exercised as of the date of the Budget that introduces the above changes, or whether, which is less likely, the changes will apply retrospectively). It has also yet to be seen whether the proposed changes will apply to options granted before but exercised after the effective date or whether they will only apply to options granted after the effective date.

Deloitte's view

Based on long-standing past practices of the Federal government, we anticipate that any changes will likely be on a prospective basis only. That said, it is important for companies to consider the potential changes to the regime in a timely manner and companies may want to communicate with employees who may be affected to allow them to best manage their affairs.

For instance, employees with vested yet unexercised stock options may want to consider the timing of future exercises of options. Additionally, some employers may (depending on the commercial circumstances) want to consider providing employees holding unvested stock options with opportunities to exercise their options early.

Contacts

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your usual Deloitte adviser or email us at globalshareplans@deloitte.co.uk, and an adviser will contact you.

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