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Global Reward Update

Quebec – Increased deduction for qualifying stock options of large publicly traded companies

Key points to know

As part of an initiative to assist large companies based in Quebec to compete with those incorporated in other parts of Canada, the Ministry of Finance (Ministère des Finances du Québec) has announced an increase to the deduction available to employees in respect of qualifying stock options.

Previously, the benefit realized on the exercise of a qualifying stock option, calculated as the difference between the fair market value of the shares at the time of exercise, reduced by the exercise price paid, was eligible for a 25% deduction from Quebec income tax. When certain criteria are met, the deduction will now increase to 50% and will be available to all qualifying options granted after February 21, 2017.

The amendments will harmonize the deduction available under the Quebec tax system with that under the federal system where a 50% deduction is already available from federal (and provincial/territorial) income tax.

This legislative change is not expected to be applied retroactively; as such, any outstanding options granted prior to February 22, 2017 that meet the qualifying conditions will continue to benefit from only a 25% deduction.

Background

Since March 13, 2008, employees of a small or medium-sized business engaged in innovative activities and meeting certain criteria have been eligible for a deduction of 50% of the benefit realized. Employees of other businesses have, until now, only been able to claim a 25% deduction. The deduction for qualifying option grants from large public companies will now increase to 50% to align with the federal tax system and that of the other provinces and territories.

In order to benefit from the increased stock option deduction, the following criteria must be met:

1) The options must be in respect of shares of a qualified corporation that are listed on a recognized stock exchange (a stock exchange designated by the Minister of Finance of Canada, or a stock exchange located in Canada or in a country that is a member of the OECD and that entered into a tax treaty with Canada)
2) The options must be granted to an employee of a qualified corporation at the time the agreement is entered into or the shares are acquired.

In order for a large corporation to be a qualified corporation, it must have paid cumulative payroll wages of at least $10 million in the year in which the options were granted. Wages in this context can be an aggregate of the following:

i. Wages paid directly to or in respect of employees who report for work at the establishment of their employer in Quebec, and;
ii. For employees who are not required to report for work at an establishment of their employer, the wages paid by the Quebec establishment directly to or in respect of such employees.

Increased stock option deduction criteria

In order to benefit from the increased deduction, stock options must initially comply with the requirements of paragraph 110(1)(d) of the federal Income Tax Act and its Quebec equivalent (the shares are often referred to as prescribed shares). In general, most standard options over common/ordinary shares should qualify; however, the detailed regulations should be considered, notably:

i. the option must be granted at the fair market value of the shares in question at the time of grant, and;
ii. the employee should not be able to force the company to reacquire his or her shares (e.g., via surrendering shares to pay the exercise price), and;
iii. the company cannot be reasonably expected to reacquire the shares within two years of issue.

Deloitte's view

The increased deduction will be welcome news to employees, due to the beneficial tax consequences, and to employers who can attract and retain talent now that option grants can compete with companies based in other parts of Canada.

This move should also simplify payroll reporting by allowing for a consistent percentage of exempt option income to be reported on the Quebec Relevé 1 (RL-1) form and the federal T4 slip.

As the legislation is not yet available, certain details remain unclear in terms of their application to particular situations and group of companies.

It must be noted that if the employer does not have an establishment in Quebec, the employees working in Quebec will not be eligible for the Quebec enhanced stock option deduction.