



TaxNewsFlash Canada

New Stock Option Rules Delayed

December 19, 2019
No. 2019-60

Finance has just announced it is pushing back the planned implementation date for new changes to the tax treatment of employee stock options, and says it will indicate how it intends to move forward with these rules—including the new coming-into-force date—as part of its 2020 budget. As a result, the proposed new changes to limit the preferential personal tax treatment of employee stock options are no longer coming into force on January 1, 2020. Finance says its delayed coming-into-force date is intended to provide individuals and businesses time to review and adjust to the new employee stock option tax rules.

Under the proposed legislative amendments, certain employee stock options that qualify for the stock option deduction will be annually capped at \$200,000. However, stock options granted by Canadian-controlled private corporations (CCPCs) and certain “highly innovative, fast-growing companies” will be exempt from the new limit.

Background

Under the current tax rules, employee stock options can receive preferential personal tax treatment in the form of a deduction (the “stock option deduction”). As a result of this deduction, employment income is effectively taxed at rates similar to capital gains. Generally, where a stock option is granted to an employee of a public company and the exercise price is equal to (or higher than) the value of the shares at the time the option is granted, the employee includes in taxable income, at the time the option is exercised, the amount by which the fair market value of the shares at the date of exercise exceeds the option price. In addition, the employee may deduct 50% of that amount as a “stock option deduction” if certain conditions are met.

The rules also provide relief where stock options are granted with respect to shares of Canadian controlled private corporations (CCPCs). In this case, the option price may be less than the fair market value of the share at the time the option is granted, but the shares must be held for two years after acquisition, or the conditions for stock options (mentioned above) must otherwise be satisfied, for the employee to claim a deduction equal to 50% of the stock option benefit. In addition, for CCPC options, the timing of taxation is deferred until the stock is sold.

Under the current rules, an employer is not entitled to a corporate tax deduction for the stock option benefit when it issues securities under the plan. Generally, where options are cash-settled instead, an employee may only be entitled to the stock option deduction if the employer elects to forego a corporate tax deduction for the stock option expense.

Finance released legislative proposals in a Notice of Ways and Means Motion for the annual cap in June 2019. These proposals, which were first announced in the 2019 federal budget, clarified that stock options granted by CCPCs and certain "highly innovative, fast-growing companies" will be exempted from the new limit. For details, see [TaxNewsFlash-Canada 2019-29, "Finance Reveals More Details on Stock Option Deduction Cap"](#) and [TaxNewsFlash-Canada 2019-14, "New Stock Option Rules Coming — Take Action Now"](#).

Finance update

Finance says it is still moving forward with its changes to limit employee stock option deduction benefits for high-income individuals employed at large, long-established, mature firms. However, Finance says it will announce the new effective date when it releases its 2020 budget.

This change in effective date, previously January 1, 2020, follows a consultation period where stakeholders were invited to provide input on the characteristics of companies that should be considered start-up, emerging, and scale-up companies for the purposes of these rules. Such corporations would not be subject to the new rules. The consultations closed on September 16, 2019. Finance says it is carefully reviewing the input received during these consultations.

KPMG observations

The Government recently indicated its intention to move forward with these proposals within its mandate letter to the Minister of Finance, for more details see [TaxNewsNow, New government set to act on tax promises](#).

Affected companies now have more time to consider additional stock option grants, as well as changes to their compensation plans to maintain the maximum stock option deduction for employees under the new rules, such as allowing options to vest over a

number of years to benefit from the \$200,000 annual cap, where possible. In addition, companies should consider internal processes for tracking several tranches of stock options qualifying for the differentiated tax treatment, and be ready for the new compliance requirements regarding grant reporting once the rules become effective.

We can help

Your KPMG adviser can help you assess the effect of the proposed stock option cap on your personal finances or business affairs, and point out ways to realize any benefits or ease their impact.

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