



# Canadian Tax Issues for Public Company Stock Options

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# Outline

- Tax implications for Canadian pubco employers
- Tax consequences for Canadian resident employees
- Cash-outs
- Independent consultant
- Non-resident employee
- Examples

# Employers - (Pubco resident in Canada)

- Stock option expense for accounting purposes are generally not deductible for calculating taxable income
- When Canadian employees exercise options, income tax and CPP must be withheld at source
- When Canadian employees exercise options, tax reporting slips (T4) must be issued before the end of February of the following year

# Employees (resident in Canada)

- Employees include officers or directors of the company
- Stock option benefit =  
FMV of shares on exercise – exercise price of the shares
- The stock option benefit is included in taxable income in the year exercised; taxed as employment income (CPP and taxes withheld)
- The tax cost of the shares acquired on exercise =  
Amount paid for the shares + stock option benefit before deduction (if any)

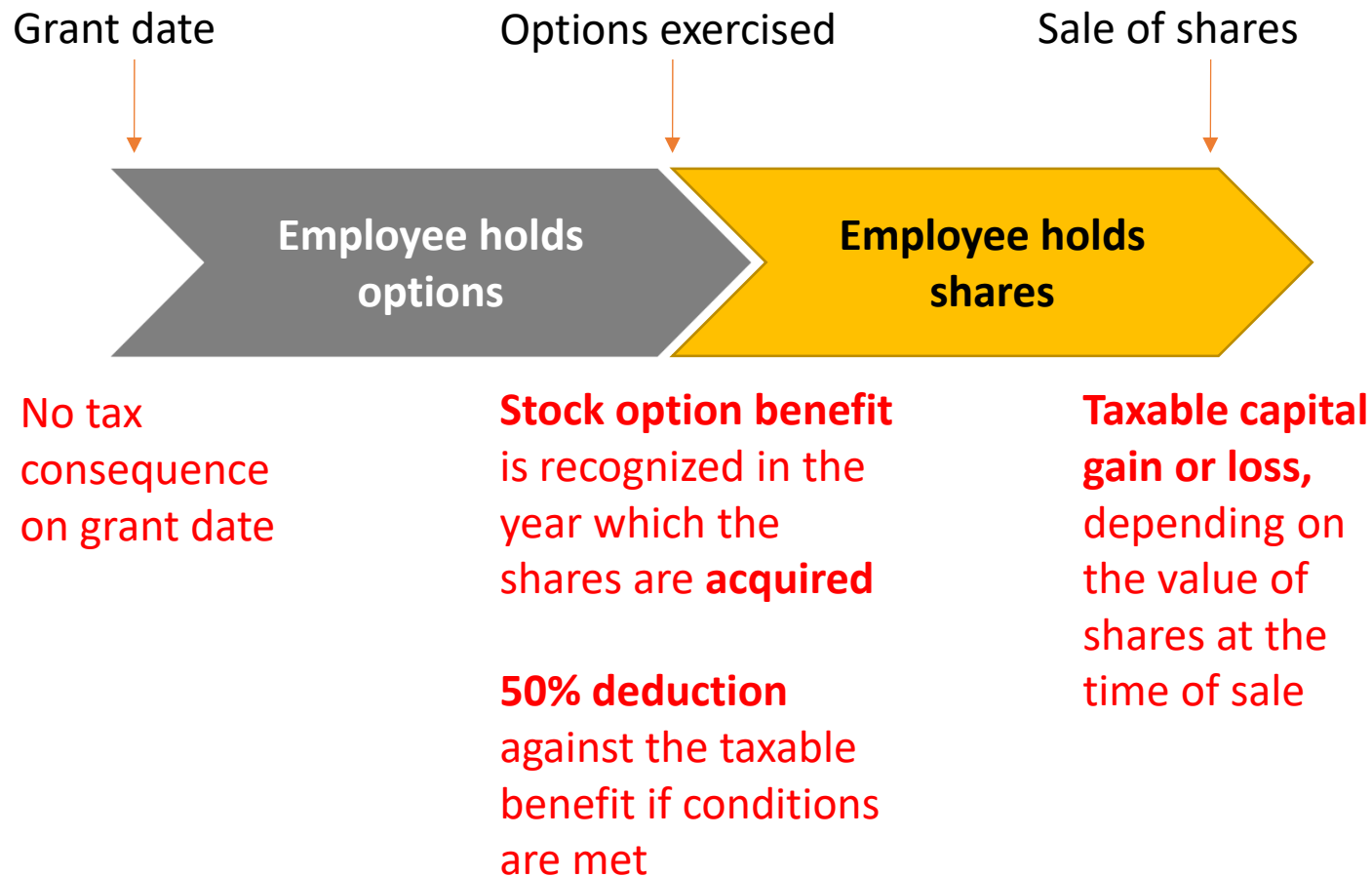
# Employees (resident in Canada)

- 50% deduction on stock option benefit for publicly traded company shares if:
  - Employee is at arm's length with the corporation;
  - The value of the shares when the option agreement is entered into did not exceed the exercise price of the option; **and**
  - Common shares are received on exercise of option.

# Employees (resident in Canada)

- If the common shares are held as capital property when the shares are sold and...
  - A lift in value of the shares since exercise → results in a capital gain → 50% is included as a taxable capital gain
  - Value of the shares decreased since exercise → results in a capital loss → 50% of capital loss is deductible against taxable capital gains in the year of realization (any excess may be carried back 3 years and forward indefinitely)
- If the shares are immediately sold after exercising the stock option, there should be no capital gain / loss

# Timelines / taxable events



# Cash Outs

- Disposal of stock option rights for cash (or equivalent) rather than for stock would be treated as ordinary remuneration
  - The cash payment is deductible from taxable income for the corporation
  - The cash payment is fully taxable in the employees' hands
- Exception, if the corporation elects not to take the deduction and provides a copy of the election to the employee, then a cash out plan can be treated as an equivalent to a stock option plan, and the employee may be eligible for a 50% deduction



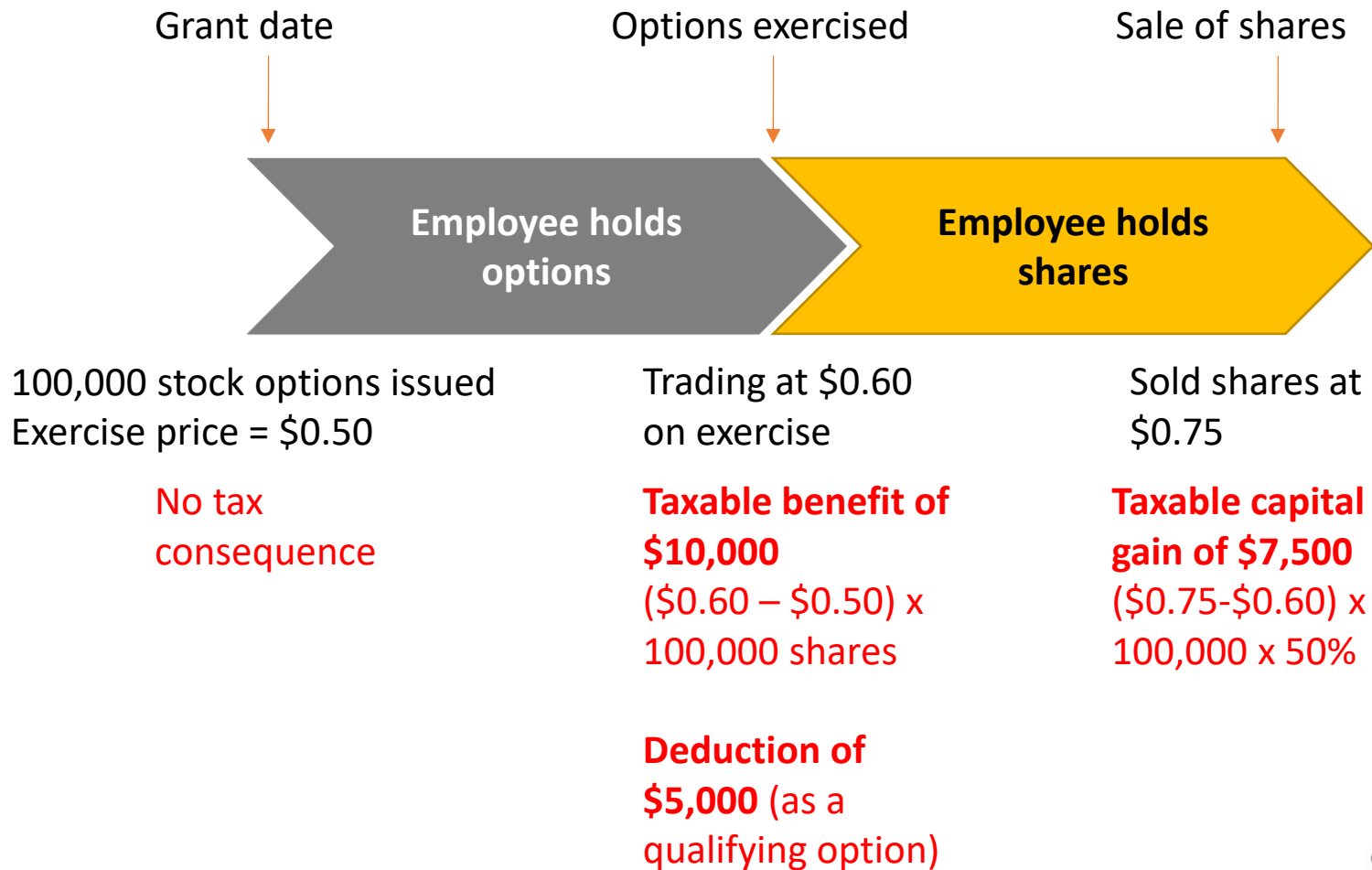
# Independent Consultant

- An independent consultant that is not an employee should report the **value** of the stock **option** as business income
- No tax implications upon exercising the stock option
- The cost of the shares acquired = exercise price + value of the stock option previously included as business income
- Upon disposition of the shares, a taxable capital gain or loss may occur

# Non-Resident Employee

- Non-resident employee granted and exercising stock options who provides **no services in Canada** is not subject to Canadian tax on stock option benefits
- Generally, if the non-resident employee is physically present in Canada, then there may be Canadian tax implications

# Example 1 – Capital Gain (Employee)



# Example 1 – Capital Gain (Employee)

- Taxable income:

Taxable benefit	\$	10,000
Less: deduction		(5,000)
Taxable capital gain		<u>7,500</u>
Taxable income	\$	12,500

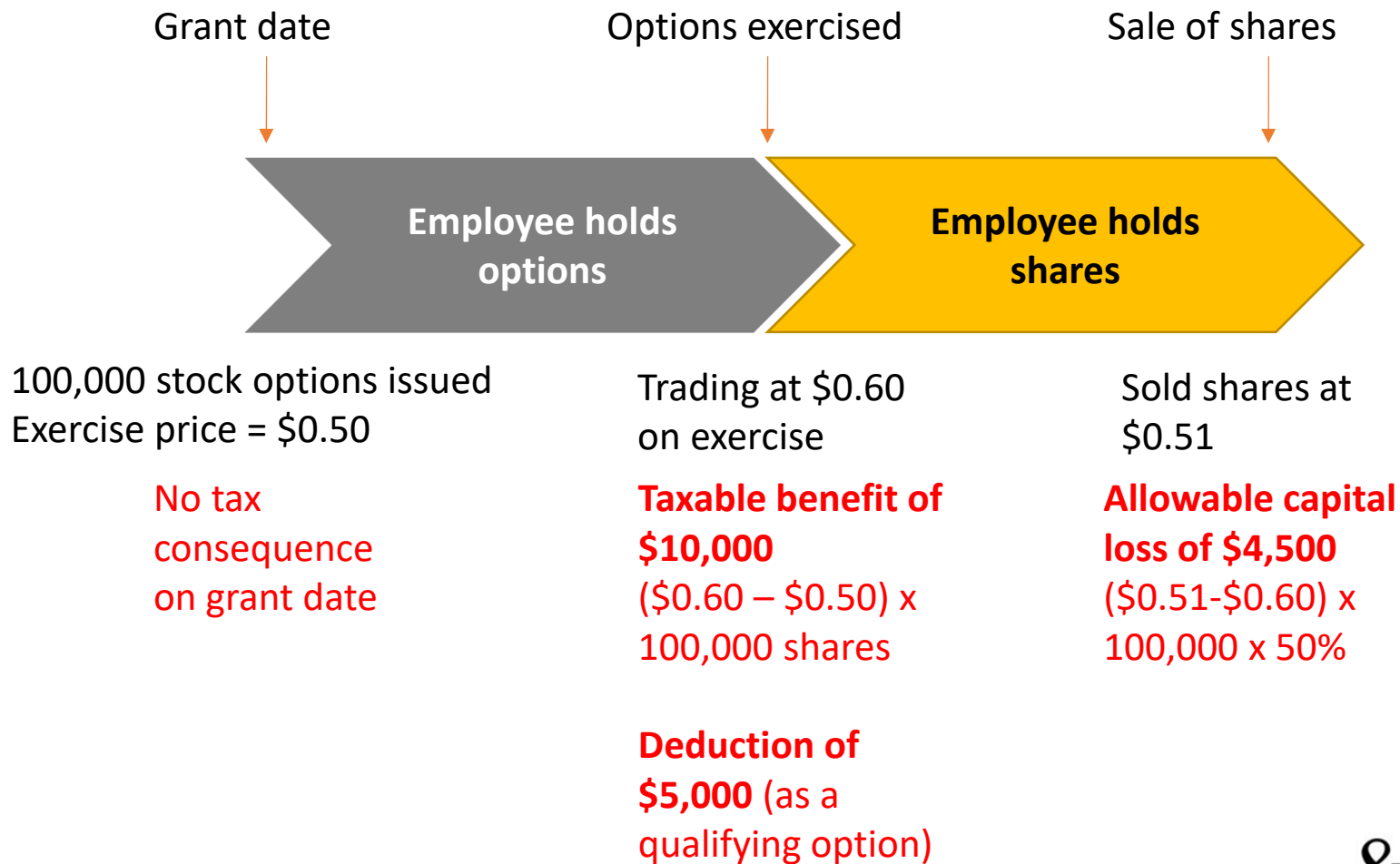
- Assuming 50% marginal tax rate, results in tax of \$6,250

# Example 1 – Capital Gain (Employee)

- End result (cash flow):

Sale of share proceeds	\$	75,000
Purchase of share		(50,000)
Tax		<u>(6,250)</u>
Net cash in pocket	\$	18,750

# Example 2 – Capital Loss (Employee)



## Example 2 – Capital Loss (Employee)

- Taxable income:

Stock option benefit	\$	10,000
Less: deduction		<u>(5,000)</u>
Taxable income	\$	5,000

- Assuming 50% marginal tax rate, results in tax of \$2,500
- Allowable capital loss of \$4,500 is applied first against current year capital gains and then may be carried back 3 years or forward indefinitely

## Example 2 – Capital Loss (Employee)

- End result (cash flow):

Sale of share proceeds	\$	51,000
Purchase of share		(50,000)
Tax on stock option benefit		<u>(2,500)</u>
Net cash in pocket	\$	(1,500)



# Recap / Wrap-up

- Stock option benefit =  
Value of shares at the time of exercise – exercise price
- Stock option benefit → taxed as income (like remunerations paid) and is subject to CPP and income taxes withheld at source
- 50% deduction available if criteria are met
- Possibly a capital gain or loss on sale of shares, if shares were held as capital property
- Capital loss must first be applied against current year's capital gain, otherwise carried back 3 years or forward indefinitely, but cannot be applied against stock option benefit