Professional Development - **IT PAYS TO KNOW**

Taking Stock of Your Options

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Table of Contents

INTRODUCTION 1
SECURITY/STOCK OPTIONS 2
EMPLOYEE STOCK PURCHASE PLANS (ESPP) 2
STOCK BONUS PLANS 3
STOCK OPTION PLANS 3
SECURITIES/STOCK OPTION CASH-OUT 8
WITHHOLDING ON SECURITY/STOCK OPTION BENEFIT 8
GST/QST/HST COMPONENTS 9
YEAR-END REPORTING 10
LEGISLATIVE CHANGES 11
DEDUCTION FOR CHARITABLE DONATION OF SECURITIES 14
PHANTOM SHARES/SECURITIES 16
SECURITY OPTIONS AND SELF-EMPLOYED CONTRACTORS 16
SECURITY OPTIONS AND THE DEATH OF AN EMPLOYEE 17
SECURITY OPTIONS AND NON-RESIDENTS 19
TERMINOLOGY 20
QUESTIONS AND ANSWERS ON STOCK-RELATED BENEFITS 22
REFERENCES: CANADA REVENUE AGENCY 30
REFERENCES: REVENU QUÉBEC 30
FEDERAL CHANGES TO EMPLOYEE STOCK OPTIONS 33

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INTRODUCTION

Employers must determine whether the employment benefits they offer are taxable employment income and subject to payroll deductions. According to the National Payroll Institute (NPI) 2015 Benefits Survey, Security/Stock Options (including cash-outs) and Stock Purchase Plans were identified as some of the most challenging benefits to administer. The NPI's Payroll InfoLine receives over 5,300 inquiries each year on taxable benefits.

A taxable benefit occurs whenever an employee enjoys a benefit provided by the employer. A security option benefit occurs when an employee acquires or receives an organization's shares for less than the fair market value (FMV). The Canada Revenue Agency (CRA) says that **fair market value** "*is normally the highest price, expressed in dollars, that property would bring in an open and unrestricted market, and between a willing buyer and a willing seller who are both knowledgeable, informed, and prudent, and who are acting independently of each other*."

The purpose of this document is to provide information related to the various aspects, types, and events that have an impact on the treatment of stock options, which consist of the following:

- Types of security/stock options plans
    - Employee Stock Purchase Plans (ESPP)
    - Stock Bonus Plans
    - Stock Option Plans
- Cash-out options
- Statutory withholding on security/stock option benefit
- GST/QST/HST components
- Year-end reporting
- Legislative changes
- Terminology
- Charitable donations of securities
- Phantom shares/securities (aka share appreciation rights)
- Security options and self-employed contractors
- Summary of benefit types
- Securities and the death of an employee
- Securities and non-resident employees
- Questions and answers
- References

Disclaimer:

This document provides general information about selected issues concerning payroll legislative and compliance issues, and/or employment and taxation laws. It is not legal advice and should not be relied upon as a substitute for legal counsel. Every effort has been made to provide accurate information; however, we advise you to seek legal counsel and advice from a qualified lawyer regarding your specific situation. Legal obligations vary according to the facts and circumstances, as well as the jurisdiction.

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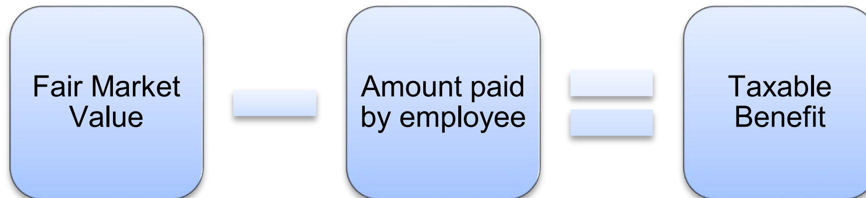
SECURITY/STOCK OPTIONS

There are three common types of security/stock option plans offered by employers:

- Employee Stock Purchase Plans (ESPP)
- Stock Bonus Plans
- Stock Option Plans

In all plan types, the taxable benefit is determined based on the following formula:



EMPLOYEE STOCK PURCHASE PLANS (ESPP)

Employee Stock Purchase Plans (ESPP) allow employees to contribute to the plan over a period of time (usually through payroll deductions) and then purchase shares on specific dates.

The benefit from the employer is generally one of the following:

- A discount on the fair market value, for example, 20%; or
- Employer matching: for example, for every four shares purchased by the employee, the employer buys one share for that employee.

In a discounted plan, the taxable benefit is determined as the fair market value less the amount the employee paid for the shares.

Example:

An employee contributes $25 per week to the ESPP and can purchase shares once per quarter at a 20% discount. At the end of quarter one, the employee contributed $325 to the plan, and the current share price is $15.

The employee purchases 27 shares at a discounted price of $12 per share for $324.

The taxable benefit will be $81, which is the difference between the fair market value ($15 x 27 = $405) and the price paid ($324).

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In an employer matching plan, the taxable benefit equals the fair market value of the shares granted by the employer.

Example:

An employee purchases 20 shares at a current fair market value of $15 per share, and the employer matches five shares (one for each of the four purchased by the employee).
The taxable benefit will be $75, calculated as 5 shares x $15 per share.

STOCK BONUS PLANS

Under Stock Bonus Plans, employees are granted shares by the employer as part of their overall compensation plan. It is very common for these types of plans to include a vesting period.

These plans may also be called Restricted Stock Units (RSU) or Deferred Share Units (DSU).

The taxable benefit equals the fair market value of the shares and should be included as income on the date the employee takes ownership of the shares.

Example:

As part of her compensation plan, Aisha is awarded 500 shares of company stock on January 1 of the current year, which will vest at a rate of 1/10 every six months, as long as she remains actively employed.

On July 1, 50 shares are now vested, and ownership is transferred to Aisha. If the fair market value of the shares on this date is $75, the taxable benefit will be $3,750 (50 x $75).

STOCK OPTION PLANS

Under Stock Option Plans, employees are granted an option, simply a written guarantee that they may purchase shares at a set price for a specified period. If the employee chooses to exercise an option and purchase shares, they will pay no more than the price per share in the option, even if the share value has increased.

Under a stock option plan, an employee who exercises their stock option may be eligible for a stock deduction if certain qualifiers are met in the transaction.

The stock deduction reduces the value on which income tax is calculated.

- Under the CRA legislation, the stock deduction equals 50% of the taxable benefit value (from January 1 to June 24, 2024) and 33.33% of the taxable benefit value (from June 25, 2024 and onwards)
- Under Québec legislation, the stock deduction is generally 25% but maybe 50% (from January 1 to June 24, 2024) under certain circumstances and 33.33% (from June 25, 2024 and onwards).

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C/QPP contributions and, if applicable, EI or QPIP premiums are always calculated on the gross amount of the benefit.

The qualifiers and application of the stock deduction depend on whether the organization issuing the shares is a Canadian-controlled private corporation (CCPC) or an entity that is not a CCPC.

CANADIAN-CONTROLLED PRIVATE CORPORATION (CCPC)

If an employee of a Canadian-controlled private corporation (CCPC) purchases shares of the corporation at a reduced price (commonly known as privately traded stocks), the resulting taxable benefit must be reported in the taxation year the employee sells or disposes of the shares, and not in the year that the employee acquires them if:

- When the agreement to sell or issue shares to the employee was concluded, the issuing or selling corporation was a Canadian-controlled private corporation.
- The employee acquired the shares after May 22, 1985.
- The employee dealt at arm's length with the corporation or any other corporation involved right after the agreement was concluded.

Example:

On January 1 of 2023, a CCPC offers an employee the option to purchase up to 100 shares for $25/share until the offer expires on December 31 of the current year.

On May 5 of the current year, the employee exercises their option and purchases 100 shares.

If the three conditions above have been satisfied, there is no taxable benefit when the shares are purchased.

The employee may be entitled to claim a deduction when they file their personal tax return under paragraph 110(1)(*d*.1) of the *Income Tax Act,* providing all of the following conditions are met:

- The shares are disposed of during the year.
- The employee did not dispose of the shares within two years of acquisition.
- The employee did not deduct an amount under paragraph 110(1)(*d*) for the benefit.

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Example continued:

The employee disposed of the shares on November 30 of 2024, and the fair market value on that date was $35/share.

The resulting taxable benefit: (100 x $35) - (100 x $25) = $1,000

If the employee meets the three conditions above, they can claim a stock deduction when filing their personal tax return equal to 50% (from January 1 to June 24, 2024) of the taxable benefit ($500) federally and 33.33% (from June 25 to December 31, 2024) and 25% ($250) of the taxable benefit for Québec income tax.

THE CRA HAS PROVIDED THE FOLLOWING EXPLANATION IN RELATION TO THE WITHHOLDING OF CCPC SHARES:

Subsection 7(1) of the *Income Tax Act* deems an employment income inclusion when a stock option is **exercised**. However, subsection 7(1.1) modifies the timing of the income inclusion where the corporation is a CCPC with which the employee dealt at arm's length. In such a scenario, employees of the CCPC will only include the taxable benefit in income in the year the shares were **disposed** of.

There is no CPP or income tax withholding requirement where a taxable benefit is received by an arm's length employee with respect to the disposition of CCPC shares, as per paragraph 153(1.01)(*b*). There is, however, still a requirement to report the taxable benefit on a T4 slip, even if the benefit is included in income when there is no longer an employment relationship. The gross amount of the stock option benefit should be reported in Box 14, "Employment Income," and in the "Other information" area using Code 38 (from January 1 to June 24, 2024) and Code 90 (from June 25, 2024 and onwards).

In addition, if specific criteria are met, the employee could claim a deduction for half the amount of the taxable benefit from January 1, 2024 to June 24, 2024 one third of the taxable benefit from June 25, 2024 to December 31, 2024 and onwards under paragraph 110(1)(*d*.1). The deduction is reported in the "Other information" area using Code 41 from January 1, 2024 to June 24, 2024 and Code 92 from June 25 to December , 2024 and onwards. See "Security options deduction for the disposition of shares of a Canadian-controlled private corporation – Paragraph 110(1)(*d*.1)" in Guide T4130, Employers Guide – Taxable Benefits and Allowances, for more information.

Since the benefit is taxable and pensionable, the employee will be responsible for paying any additional income tax when they file their T1 and may opt to file a CPT20, Election *to* Pay Canada Pension Plan Contributions, if the maximum annual contribution hasn't already been reached. In some cases, employers could receive a PIER report from the CRA because pensionable earnings reported on the employee's T4 slip may not agree with the deductions the employer withheld, and they will have to explain the deficiency.

There have been no changes to the treatment of taxable benefits arising from the disposition of CCPC shares since 2010. An internal CRA technical interpretation, 2017-0709811I7 – *Withholding on CCPC stock option benefit*, reiterates the CRA's position.

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QUESTIONS AND ANSWERS

Q. Does this mean no CPP or income tax is required on CCPC share exercises under all circumstances?

Yes, as long as the corporation is a CCPC with which the employee dealt at arm's length, a taxable benefit only arises when the shares are disposed of. Therefore, income tax and CPP do not apply when the shares are exercised because there is no taxable benefit yet. The reasoning is that it is difficult to determine the fair market value of CCPC shares until they are sold.

Q. Is the employee only required to pay source deductions when they file their personal tax return?

Yes, there is no income tax or CPP withholding requirement for the employer. The employee will be responsible for paying additional income tax when they file their T1. They may elect to pay contributions to the CPP (both employer and employee portions) on the benefit by completing form CPT20 Election to Pay Canada Pension Plan Contributions where appropriate.

Q. Is it understood that the employer must only report the taxable benefit and the applicable deduction?

Yes, the employer is only responsible for reporting the taxable benefit (and any applicable deduction) on a T4 slip, even when there is no longer an employment relationship.

For example, an employee who received an option to purchase shares from a CCPC (with which they dealt at arm's length) exercises their right to buy the shares, later selling $10,000 worth of the shares back to the corporation (their employer). The employer pays $10,000 cash for the shares.

In this scenario, the remuneration the employee receives is the shares. The income inclusion is just deferred because the value is too difficult to determine until the shares are sold. Once the shares are sold, the value is determined ($10,000). The employer would then include the $10,000 benefit on the employee's T4 slip and would not be required to withhold it.

Once the shares are the employee's property, and that employee chooses to sell the shares back to their employer, any amount the employee receives for the shares is not employment income.

Revenu Qubec's position:
Revenu Québec has confirmed to the Institute that once the shares are exercised/sold, they become a taxable benefit to the employee. They are, therefore, subject to QPP and income tax, and are reported on the RL-1 in Boxes A and L with a 25% deduction in Code L-10 (from January 1 2024 to June 24, 2024) and under Code L-13 (from June 25, 2024 and onwards. The rate of deduction must also be reported under Code L-11 (from June 25, 2024 and onwards). The employer must withhold QPP and Québec provincial tax as usual.

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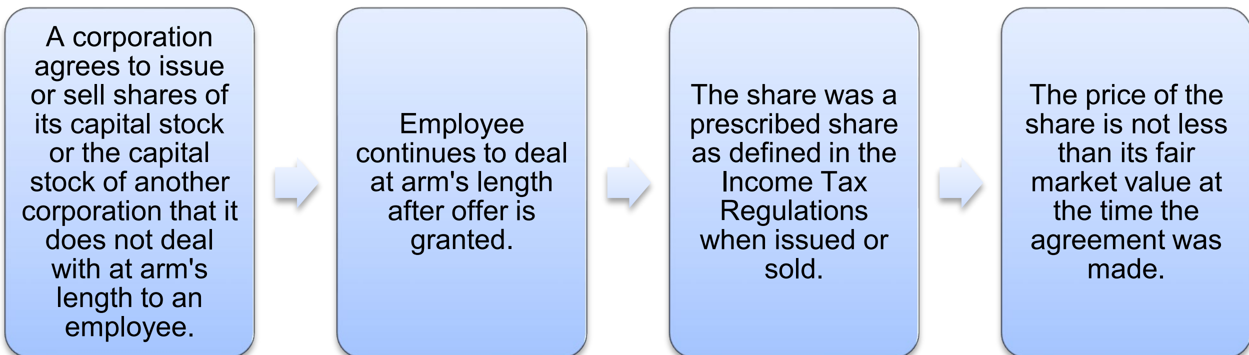
ENTITIES OTHER THAN CANADIAN-CONTROLLED PRIVATE CORPORATIONS

If the entity is not a CCPC, an employee is considered to have received a taxable benefit in the taxation year they acquired the shares (commonly known as publicly traded stock). When the option is exercised, the employer must deduct and remit the C/QPP and income tax.

Under paragraph 110 (1)(*d*) of the *Income Tax Act*, an employee can claim a deduction when filing their personal tax return if the following four conditions are met:



When the four conditions outlined above are met, the employee is eligible to claim a stock deduction when filing their tax return, reducing the amount upon which income tax is calculated. Federally, the deduction equals 50% (from January 1 to June 24, 2024) and 33.33% (from June 25, 2024 and onwards) of the taxable benefit; in Québec, it equals 25% or 50% (from January 1 to June 24, 2024) and 25% or 33.33% (from June 25, 2024 and onwards).

Example:

On January 1 of 2024, a public corporation agrees to sell its shares to an employee at the current fair market value of $25/share until the offer expires next year on December 31. In February of the current year, when the fair market value is $40/share, the employee exercises their option and buys 100 shares for $2,500.

The resulting taxable benefit: ($40 x 100) – ($25 x 100) = $1,500

If the transaction meets the above four qualifiers, the stock deduction that applies to the $1,500 taxable benefit will be:

> Federal: $1,500 @ 50% = $750 (from January 1 to June 24, 2024) and $1,500 @ 33.33% = $499.95 (from June 25, 2024 and beyond)
> Québec: $1,500 @ 25% = $375

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SECURITIES/STOCK OPTION CASH-OUT

Employees may receive cash instead of securities when they exercise their options. Generally, the cash paid is equal to the difference between the fair market value of the securities when the options are exercised and the exercise price of the securities. This amount equals the employment benefit the employee is deemed to have received. As the employer, you must withhold the appropriate amount of income tax because you are paying the benefit in cash to the employee.

Suppose the employee disposes of stock option rights to the employer for a cash payment or other in-kind benefit. In that case, the employee can claim the security options deduction if eligible, or the employer can claim the cash-out as an expense, but not both. If the employer elects not to claim the cash-out as an expense, the employer enters that amount in Code 86, "Security options election," of the T4 slip. This would allow the employee to claim the deduction under paragraph 110(1)(*d*). If Code 86 of the T4 slip is not completed, this means that the employer decided to claim the expense, and the employee would not be allowed to claim the deduction under paragraph 110(1)(*d*).

WITHHOLDING ON SECURITY/STOCK OPTION BENEFIT

The withholding amounts for a stock transaction must be calculated using the bonus tax method. The required statutory deductions depend on the type of transaction.

- Non-cash transaction: the employee holds the shares purchased or received
    - C/QPP contributions
    - Federal and provincial income tax
- Cash transaction: the employee receives the cash value of the benefit
    - C/QPP contributions
    - EI and QPIP premiums
    - Federal and provincial income tax

Although the CRA requires employers to withhold CPP from the employee whether the benefit is processed in a pay period where there is remuneration or not, Revenu Québec has confirmed to the Institute that there is no requirement to withhold QPP if there is no remuneration paid in the pay period in which the benefit is processed.

No guidelines exist on how to make sufficient deductions at source, especially when an employee's tax liability is more than their pay for that period. In this situation, the employer may have to make special arrangements with the employee to send in the tax shortages by cheque or pre-authorized debit. In some cases, such an employee may realize the need to dispose of some shares to afford the withholding obligations.

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Consider the following scenarios:

- If an employee elects for a cash transaction, employers must develop procedures with the stock options administrator to ensure that C/QPP contributions, EI or QPIP premiums, and income taxes are withheld from the transaction to meet the requirements.
- If an employee exercises and holds some or all of the shares, it should be a requirement that the employee provides payment of the grant price of the shares, as well as the necessary C/QPP contributions and income tax, before the transaction is permitted to proceed.
- Payment can be managed by selling enough shares to cover the cost or providing a cheque for the liabilities.

GST/QST/HST COMPONENTS

There are no taxable GST/QST/HST components on a security/stock option taxable benefit.

PLAN TYPES – ELIGIBILITY FOR STOCK DEDUCTION – STATUTORY WITHHOLDING REQUIREMENTS

Plan type	Taxable benefit equals	Stock deduction	C/QPP	EI / QPIP	Income tax
Employee Stock Purchase Plan (ESPP)	Fair Market Value less the amount paid by the employee	N	Y	N	Y
Stock Bonus Plan • Restricted Share Units (RSU) • Deferred Share Units (DSU)	Fair Market Value of shares given to the employee	N	Y	N	Y
Stock Options	Fair Market Value less the amount paid by the employee	Y [1]	Y	N	Y
Cash Benefit	Cash received instead of shares	Y [2]	Y	Y	Y

[1] If transaction meets qualifiers for stock option deduction.
[2] If transaction meets qualifiers for stock option deduction and employer forgoes their right to claim a tax deduction.

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YEAR-END REPORTING

The taxable benefit is reported in the following:

From January 1, to June 24, 2024

- Box 14 of the T4 slip, along with the following applicable codes in the “Other information” area:
  - 38 – security/stock option benefits;
  - 39 – security/stock option and shares deduction 110(1)(*d*) (public security/stock);
  - 41 – security/stock option and shares deduction 110(1)(*d*.1) (CCPC); and
  - 86 – security options election (cash-out).
- Boxes A and L of the RL-1 slip with the following applicable boxes in the “Additional information” area:
  - L-9 – Security options deduction for the acquisition of shares or units of entities other than CCPC (publicly traded stock) to record the additional information related to the stock option deduction, as per article 725.2 of the *Taxation Act;*
  - L-10 – Security options deduction for the disposition of shares or units of a CCPC (privately traded stock) to record the additional information related to the stock option deduction, as per article 725.3 of the *Taxation Act*; and
  - L-8 – Election respecting security options (cash-out).

From June 25, 2024 and onwards

- Box 14 of the T4 slip, along with the following applicable codes in the “Other information” area:
  - 90 – security/stock option benefits;
  - 91 – security/stock option and shares deduction 110 (1) (d) (Public security/stock);
  - 92 – security/stock option and shares deduction 110 (1) (d.1) (CCPC); and
  - 86 – security options election (cash-out).
- Boxes A and L of the RL-1 slip with the following footnote:
  - L-12—Security options deduction for the acquisition of shares or units of entities other than Canadian-controlled Private Corporation, to record the additional information related to the stock option deduction, as per article 725.2 of the *Taxation Act,*
  - L-13—Security options deduction for the disposition of shares or units of a CCPC (privately traded stock) to record the additional information related to the stock option deduction, as per article 725.3 of the Taxation Act; L-8 security options election (cash-out).
  - L-11—Rate of deduction entered in box L-12 or L-13
  - L-8 – Election respecting security options (cash-out).

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LEGISLATIVE CHANGES

Some of the complexity in managing stock benefits lies in the fact that there have been several legislative changes over the past few years that have been drastic. Take March 4, 2010, for example. Before that date, employees were allowed to defer paying taxes when they acquired securities until such a time when the employee sold the shares. The employee would file an election with the CRA, and the employer would report the benefit amount in Code 53 of the T4 slip.

The problem with this process was that employees were deferring the original valuation of the shares and were required to pay taxes on the original acquisition amount. If they sold the shares for less than the acquisition price, they incurred a loss and were still required to pay the income tax on the original acquisition price. This would have been disastrous if they had purchased the shares originally for $100 and ended up selling them for $1. Although this did not often occur, in those cases where it did, it was catastrophic for some employees who were forced to refinance or even lose their homes to cover the tax liability.

Due to such events, deferrals were eliminated as of the Federal Budget on March 4, 2010. Furthermore, the government announced that effective January 1, 2011, all applicable income taxes needed to be paid at the time the shares were exercised/acquired by the employees.

Before January 1, 2011, the CRA exercised a certain degree of flexibility that enabled an employer to allow an employee to claim undue hardship and either pay the income taxes later or even when they filed their personal tax return.

As a result of these new requirements, employers are now required to assume a more active role in the collection and remittance of C/QPP contributions and income tax (the source deductions that non-cash security options are subject to).

These changes are the most recent as far as stock options are concerned. There have also been several changes to the capital gains deduction amounts over the years that have caused confusion.

The complexity increases for employers in Québec, where the deduction is generally 25% rather than the 50% set by the CRA. Adding to this, a 50% stock deduction may also apply in Québec under certain circumstances.

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<u>NEW RULES</u> (for year 2024 and beyond)

Stock option benefits exercised on or after June 25, 2024, will be subject to new rules regarding capital gains. The proportion of taxable capital gains increased from one-half to two-thirds, starting June 25, 2024. The new rate applies to net capital gains exceeding $250,000 per year for individuals and all net gains realized by corporations and most trusts. Employers will not be responsible for monitoring an employee's total capital gains for the year, which may include non-employment gains such as the sale of an investment property. Instead, all transactions eligible for a stock option deduction will now be subject to a capital gains exemption of 1/3 (33.33%). Employees entitled to a greater exemption rate will have this reconciled when they file their personal tax returns. Employees who regularly exercise stock option benefits through their employer, who would be eligible for the additional tax exemption, can apply to the CRA for a letter of authority. The employee must complete form T1213 Request to Reduce Tax Deductions at Source and submit it to the CRA with any relevant documents. A letter of authority will be issued with the approved tax relief.

QUÉBEC GOVERNMENT INTRODUCES CHANGE ON FEBRUARY 21, 2017

The Québec government introduced a change on February 21, 2017. Québec Ministry of Finance Bulletin 2017-3 announced that the stock option deduction will be increased from 25% to 50% for public securities whose Québec annual payroll is at least $10 million. This applies to all security options granted after February 21, 2017.

This initiative does not apply to shares issued by a CCPC, only to shares issued by a qualifying stock exchange.

The *Taxation Act* provides that for an employee who is terminated before all conditions have been met, that would make the legislative provisions pertaining to the inclusion of the value of a benefit respecting a stock option applicable, those provisions apply as though the person were still an employee and as though the office or employment was still in existence.

The Québec government also allows a stock option deduction of 50%, where the option is granted after March 13, 2008, by a small- or medium-sized business engaged in innovative activities. (See Bulletin 2017-3.) This initiative aims to incentivize small- to medium-sized organizations to be creative and involved in research and development. To qualify for the 50% deduction, the organization must meet the following qualifiers:

- Carries on business in Québec and has an establishment in Québec;
- Total assets must be less than $50 million; and
- A refundable R&D tax credit (Research and Development) was granted to the corporation for its taxation year ending in the given calendar year or for one of the three previous taxation years.

QUÉBEC ANNOUNCES CAPITAL GAINS INCLUSION RATE

On June 19, 2024, the Québec government announced that starting June 25, 2024, the capital gains inclusion rate of 50% will increase to 66.7% for the portion of capital gains realized by an individual during a year that exceeds $250,000.

- This means that an individual will now have to take into account two inclusion rates if their capital gains exceed the threshold of $250,000.
- Currently, when an individual realizes a capital gain (or loss), 50% of the capital gain is taxable, while 50% of the capital loss is deductible.
- This threshold of $250,000 will apply to capital gains realized in a year by an individual, directly or indirectly, through a partnership or a trust, after deduction, among other things, of his losses in capital for the year and its capital gains in respect of which the cumulative capital gains exemption was claimed for the year.
- The annual threshold of $250,000 from which individuals will benefit will apply for the entire year 2024, that is to say, it will not be calculated in proportion to the number of days.
- However, net capital losses from previous years will continue to be deductible against taxable capital gains realized from June 25, 2024. Their values will be adjusted in order to take into account the capital gains on which the new rate inclusion will apply. Thus, a capital loss suffered before the rate change will fully offset an equivalent capital gain realized after this change.
- Note that the increase in the capital gains inclusion rate to 66.7% will also apply to corporations and trusts, but in general, the latter will not benefit from the annual threshold of $250,000.

DIFFERENT TERMINOLOGY CAUSES CONFUSION

In addition to legislative changes, confusion often arises with defining the different types of benefits.

Regarding the CRA, there are two types of securities: Canadian Controlled Private Corporations (CCPC), the definition of which can be found in the CRA bulletin IT-458R2, and every other type.

The “every other type” almost always represents public securities that trade on the stock exchange. However, they can also be private securities from another country. The main difference between the two are:

- Employees not from a CCPC pay their taxes when they acquire securities, while employees of a CCPC only pay their taxes when they sell their shares back to the employer after a two-year holdover period. The reason is that only in this case are employees able to sell the shares through the employer.

- The two-year holdover period has been put in place by the CRA likely to maintain the integrity and characteristics representative of a CCPC. If the two-year condition is unmet, the amount could be considered a bonus or phantom shares/securities. (Phantom shares/securities, sometimes called share appreciation rights (SARs), are addressed later in this document.). Sometimes, they may also qualify for a deduction as a non-CCPC.

DEDUCTION FOR CHARITABLE DONATION OF SECURITIES

If an employee acquires a security under an option and donates it to a qualified donee (other than a private foundation), the employee is entitled to a deduction under paragraph 110(1)(d.01) of the *Income Tax Act* in addition to the stock option deduction. In general, the deduction is equal to **one-half** of the security option benefit. It should be noted that if the value of the security is worth less when it is donated than when it was acquired, the deduction is based on the lesser of the:

- employment benefit deemed by subsection 7(1) of the Act to have been received by the employee; and
- employment benefit that would have been deemed by subsection 7(1) of the Act to have been received by the employee had its value at the time it was acquired been that lesser value.

The employee can claim this additional deduction if the following conditions are met:

- The donation must be made:
  - 30 days from the day the security is acquired; and
  - within the year in which the security is acquired;
- The employee must be eligible for the deduction under Security options deduction for the acquisition of shares or units of entities other than a Canadian-controlled private corporation - Paragraph110(1)(*d*) of the Act; and
- If the security is a share, it must be of a class listed on a prescribed Canadian or foreign stock exchange.

In the case of a donation of securities, the employer may reduce the benefit by an additional 50% deduction, available under Donation of securities – Paragraph 110(1)(*d*.01). To reduce the benefit. The employer must receive either:

- a written undertaking from the employee that the shares will be donated to a qualified donor within the time limits; or
- actual proof that the donation has been made.

By virtue of subsection 110(2.1), a deduction under paragraph 110(1)(*d*.01) may also be available where an employee, in exercising an option, directs the appointed or approved broker or dealer to immediately sell the security and donate all or part of the proceeds of the disposition to a qualified charity. The amount of the deduction must be prorated to reflect the portion of the profits that are donated.

Example:

On January 1 of 2024, a public corporation agrees to sell its shares to an employee at the current fair market value of $50/share until the offer expires next year on December 31. In February of the current year, when the fair market is $70/share, the employee exercises their option and buys 100 shares for $5,000.

The resulting taxable benefit: ($70 x 100) – ($50 x 100) = $2,000

When an employee donates shares to a registered charity, the employee receives a deduction equivalent to the total amount. They will receive a 50% capital gains deduction (from January 1 to June 24, 2024) and a 33.33% deduction (from June 25, 2024 and onwards), 25% or 50% in Québec (from January 1 to June 24, 2024) and 25% or 33.33% (from June 25, 2024 and onwards), and an additional deduction for the donation.

The entire amount of the benefit, $2,000, is subject to C/QPP.

However, the deduction reported in Code 39 (from January 1 to June 24, 2024) and Code 91 (from June 25, 2024 and onwards) of the T4 slip and Code L-9 (from January 1 to June 24, 2024) and Code L-12 (from June 25, 2024 and onwards) of the RL-1 is as follows:

Federal: $2 000 @ 100% = $2,000
Québec: $2 000 @ 50% = $ 1,000

PHANTOM SHARES/SECURITIES

Often employers provide benefits to employees based on share evaluations. For example, an employer could take the value of the shares at the beginning of a fiscal year and perform a comparative analysis at the end of the year. They would then take the difference between the beginning and ending values and multiply it by a certain number of shares and pay this amount to their employees.

Although the foundation of this benefit is based on shares, it is not considered a stock option benefit. These are known as phantom shares/securities or share appreciation rights. The CRA and Revenu Québec require the employer to treat any amount paid to employees out of these plans like a bonus and subject to all source deductions for C/QPP, EI, QPIP, and federal and provincial income tax. The income tax would be calculated using the bonus method on the total amount.

Example:

On July 1 of the previous year, an organization's shares were trading at $11.00 a share. On June 30 of the current year, the shares were trading at $13.00. The employer takes the share appreciation value multiplied by a certain number of shares and gives the resulting amount to the employee as a cash payment.

($13.00 - $11.00) x 1,000 = $2,000.00

As no actual shares are being exchanged, the amounts must be reported as a bonus subject to all source deductions of C/QPP, EI, QPIP, and income tax using the bonus method on the entire amounts.

SECURITY OPTIONS AND SELF-EMPLOYED CONTRACTORS

A contractor/self-employed individual who is not an employee and receives stock options should not have the options reported as employment income on the T4 slip. The total amount should be reported on a T4A slip in Box 048.

The amount reported is considered business income in the year it is granted. The value is the fair market value of the security at the time of grant, less any amount paid by the contractor for the options. There would not be any deduction under paragraph 110(1)(*d*) since the contractor/self-employed individual presumably paid nothing for the options.

Because the securities are not considered employment income when provided to contractors/self-employed individuals and the amounts are reported as "fees for services" in Box 048 of the T4A slip, there is no requirement to withhold C/QPP or income tax.

Employers are also not required to report self-employment income in Québec on the RL-1 unless income tax is withheld, or the payments are for individuals or businesses.

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Employers must ensure recipients are truly self-employed.
Employers and/or payers must ensure that the individual in question qualifies as self-employed as illustrated in the CRA's RC4110 Employee or Self-employed Guide or IN-301 Employee or Self-Employed Person.

If employers treat an individual as self-employed and either and/or the CRA or RQ (in the eventuality of an audit) deem the recipient to be an employee, the employer will likely be required to treat the individual that was treated as self-employed as an employee.

This would mean the employer must cancel the T4A slip, produce, or amend T4s and RL-1, and remit the applicable source deductions.

SECURITY OPTIONS AND THE DEATH OF AN EMPLOYEE

If an employee dies owning unexercised securities, the benefit must be reported immediately. Although the option exercise must be reported, it would be subject to C/QPP only if there is remuneration processed at the same time. The benefit would not be subject to QPP if no remuneration was paid when the shares were exercised. The benefit, however, is not subject to federal or Québec income tax. The benefit and deduction would be reported as usual.

In Québec, the benefit amount would be reported on the RL-1 in Boxes A and L and Code L-7. Code L-7 is recorded when the employee is deceased. There is no deduction, however, reported on the RL-1 form.

An internal CRA technical interpretation (TI) confirms that an employee who holds unexercised employee stock options at the time of death is deemed to have received a benefit in the year of death equal to the stock options' value immediately after death, net of their cost of acquisition (TI 2009-0327221I7, December 21, 2012). The deceased's estate is deemed to have acquired the options at a price equal to their fair market value.

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Employer Reporting Requirements
When an employee holds unexercised employee stock options at the time of death, under paragraph 7(1)(*e*) of the *Income Tax Act*, they are deemed to have received an employment benefit in the year of death equal to the options' value immediately after death less any amount that they paid to acquire them. (Paragraphs 7(1)(*b*), (*c*), and (*d*) of the stock option rules do not apply if paragraph 7(1)(*e*) applies.)
When an option provides that it is automatically canceled on an employee's death, its value immediately after death is nil, and no amount is included in the deceased's income under paragraphs 6(1)(*a*) and 7(1)(*e*).
However, if the option's terms provide that the estate may exercise the option for a limited period—one year after the employee's death—then paragraph 7(1)(*e*) may result in an income inclusion for the employee.
The TI states that if a deceased's estate receives an employee stock option, generally, paragraph 69(1)(*c*) deems its added cost base (ACB) to the estate to be its fair market value at the time that the estate acquires it. (That ACB is reduced under paragraphs 53(2)(*t*) and 164(6.1)(*b*) by the subsection 164(6.1) loss, if any.)
In general, if an estate exercises an employee stock option, its ACB is added to the cost of the shares (subparagraph 49(3)(*b*)(ii)).
The CRA says an option may decline in value after the taxpayer's death. Then the benefit realized by the estate on its exercise or disposition is less than the benefit that must be reported by the deceased under paragraph 7(1)(*e*). Subsection 164(6.1) can provide relief if the option is exercised, expires, or is otherwise disposed of within the estate's first taxation year. If the legal representative elects in the prescribed manner, the loss has been deemed a loss from the deceased's employment for the year of death. The loss amount (paragraph 164(6.1)(*a*)) equals the amount of the benefit deemed received by the deceased in the year of death under paragraph 7(1)(*e*) minus the option's value immediately before its exercise or disposition, net any amount that the deceased paid to acquire the option. Suppose one-half of the option benefit was deducted under paragraph 110(1)(d) vis-à-vis the deceased's income inclusion in the year of death under paragraph 7(1)(e). In that case, the loss carryback is reduced by paragraph 110(1)(*d*) deduction.

In the year of death, an employer must report the amount of the employment benefit, calculated under paragraph 7(1)(*e*), on the appropriate information return in the deceased employee's name.

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SECURITY OPTIONS AND NON-RESIDENTS

The reporting and taxation of security options for non-residents can be pretty complex. How and when they are reported and knowing what source deductions are withheld and remitted depends on which non-residents receive the options and under what circumstances.

First and foremost, if the stock options are granted by a Canadian company, they must be reported by the Canadian corporation on a T4 slip when they are exercised, regardless of where the employee or former employee resides at the time of exercise or where the services were performed.

The reasoning is that stock options are subject to withholding under subsection 153(1) of the *Income Tax Act*. Therefore the payer (employer) must prepare an information return under Regulation 200 of the Income Tax Regulations.

If the income from a stock option benefit is not sourced to Canada (i.e., taxed in Canada), there is no requirement to withhold income tax on the security options. In other words, if the services are not performed in Canada, and the employee is not a resident of Canada, Regulation 104(2) states that "no amount shall be deducted or withheld." However, a T4 slip is still required.

If receipt of the options is by virtue of the employee's employment in Canada, the employer must withhold income tax and CPP when the employee acquires the shares, whether the employee is resident in Canada or not.

Where the taxable benefit is for a non-resident, the withholding is calculated as if the employee were a resident. In addition, the employer can take into consideration the 110(1)(*d*) or (*d*.1) deduction if the employee is eligible to reduce the amount subject to tax.

This will be the case if the employee is no longer employed with the organization, whether Canadian or non-resident. Because the option exercise is attributed solely by virtue of the employee's employment in Canada, the employer is responsible for calculating and remitting source deductions as usual, although the employee may no longer be resident in Canada.

Suppose the employee is still employed by the overall organization and is granted the options in Canada. In that case, the portion of the exercise representing the period the employee is in Canada can be exercised in Canada, and the period the employee is in the other country is exercised in that country.

For example, the employee in question has been employed with the organization for three years. The employee was employed in Canada for the first two years, and for the other year, in the U.S. The employer would report two-thirds of the option benefit value in Canada and the other one-third in the U.S.

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TERMINOLOGY

Security/Stock Option Terminology and Definitions – for entities other than CCPCs	
Employee Share Purchase Plans	Employee acquires the shares from the employer at a discount (ex: 15%). The benefit is reported in Box 14 and Code 38 or Code 90 of the T4 slip and Boxes A and L of the RL-1.
Employee Cash-out Option	When the employee sells their shares back to the employer upon exercise. The benefit is reported in Box 14, Code 38 or Code 90, and Code 86 (if the employer forgoes claiming the payment as company expense) of the T4 slip with the 50% or 33.33% deduction in Code 39 or Code 91. For Québec reporting, the benefit is reported in Boxes A and L and Code L-8 (if the employer forgoes claiming the payment as company expense) and the 25 or 50% (or 33.33%) deduction in Code L-9 or Code L-12.
Phantom Shares/Securities (aka Share Appreciation Rights)	Consists typically of share evaluations using formulas based on share performance to determine a bonus amount to be paid. These are not real shares and are reported as income in Box 14 and Code 40 of the T4 slip and Boxes A and L of the RL-1 and are subject to C/QPP, EI, QPIP, and income tax.
Restricted Stock Units	Compensation is issued by an employer to an employee in the form of company stock. The benefit is subject to C/QPP and income tax and reported in Box 14 and Code 38 or Code 90 of the T4 slip and Boxes A and L of the RL-1.
Share Appreciation Rights	Another way to describe phantom shares/securities. Consists typically of evaluations using formulas based on shares to determine a bonus amount to be paid. These are not real shares and would be reported as income in Box 14 and Code 40 of the T4 slip and Boxes A and L of the RL-1 and would be subject to C/QPP, EI, QPIP, and income tax
Stock Bonus Plans	Type of profit-sharing plan paid in employer stock instead of cash and referred to as Restricted Stock Units. The benefit is subject to C/QPP and income tax and reported in Box 14 and Code 38 or Code 90 of the T4 slip and Boxes A and L of the RL-1.
Stock Options	The employee acquires the shares at a price that can be no less than the fair market value of the shares on the date the agreement was signed. The benefit is reported in Box 14 and Code 38 or Code 90, and the 50% or 33.33% deduction is in Code 39 or Code 91 of the T4 slip. For Québec reporting purposes, the benefit is reported in Boxes A and L, and the 25% deduction is in Code L-9 or Code L-12 of the RL-1.

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The table below summarizes the T4 reporting requirements for the 2024 tax year.

	January 1 to June 24, 2024	June 25 to December 31, 2024, and beyond
Taxable Benefit	Box 14 and Code 38	Box 14 and Code 90
Stock Deduction (non-CCPC)	Code 39 (50% of Code 38)	Code 91 (33.33% of Code 90)
Stock Deduction (CCPC)	Code 41 (50% of Code 38)	Code 92 (33.33% of Code 90)

The table below summarizes the RL-1 reporting requirements for the 2024 tax year.

	January 1 to June 24, 2024	June 25 to December 31, 2024, and beyond
Taxable Benefit	Box A and L	Box A and L
Stock Deduction (non-CCPC)	Footnote Code L-9 (25% or 50% of Box L)	Footnote Code L-12 (25% or 33.33% of Box L)
Stock Deduction (CCPC)	Footnote Code L-10 (25% or 50% of Box L)	Footnote Code L-13 (25% or 33.33% of Box L)
Rate of deduction entered in Box L-12 or L-13		Footnote Code L-11

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QUESTIONS AND ANSWERS ON STOCK-RELATED BENEFITS

1. **Our organization has several stock-based plans: restricted stock units, stock option plans, and share purchase plans. How and when are these taxable benefits reported? We find the whole process extremely confusing and would like to obtain as much clarification as possible**.

   Stock options in and of themselves are not as complicated as one may think. In many cases, the challenge associated with the reporting of these benefits can be attributed to how the information is communicated to the payroll department.

   In many instances, the terminology used to describe the type of security option benefit an employee is about to receive does not correspond with the definitions used by the CRA/Revenu Québec.

   This can often be attributed to the fact that the security benefits consist of public securities originating from outside Canada. Naturally, the treatment of security options can vary significantly from one country to the next. Once the information has been transmitted to the Canadian payroll department by the head office outside Canada, the originating country often uses terminology that refers to the tax reporting treatment applicable in that country, which may be quite different.

   To simplify matters, the Canadian payroll department must be aware of the various treatment and reporting requirements required for security options in Canada.

   The key factor to be mindful of is that in Canada, the security options become taxable when the employee acquires the shares, whether the employee sells the shares or not.

   Security options can be broken down into three types of plans as outlined below:

Types of options issued to employees:

- **Stock option plan:** This allows the employee to purchase shares of the employer's company or a non-arms-length company at a predetermined price.

  These amounts are reported in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) of the T4 slip and Boxes A and L of the RL-1. The benefits are subject to C/QPP and income tax and are the only type of stock option plan where a 50% deduction is reported in Code 39 (33.33% deduction reported in Code 91 from June 25, 2024 and onwards), and a 25/50% deduction is reported in Code L-9 (25/33.33% deduction is reported in Code L-12 fom June 25, 2024 and onwards) of the RL-1.

- **Employee stock purchase plan (ESPP):** This plan allows the employee to acquire shares at a discounted price (i.e., for an amount that is less than the value of the stock at the time of the acquisition of the shares). Many ESPPs provide for a delay in acquiring the shares: an employee contributes a certain amount over a period of time, and at specified periods, the employee can purchase shares at a discount using the accumulated contributions. The benefit equals the value of the shares minus the amount paid. These amounts are reported in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) of the T4 slip and Boxes A and L of the RL-1 and are subject to C/QPP and income tax.

- **Stock bonus plan:** Under this plan, an employer agrees to give the shares to the employee free of charge. The employer agrees to sell or issue shares to the employee for no cost.

  These amounts are reported in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) of the T4 slip and Boxes A and L of the RL-1 and are subject to C/QPP and income tax.

Capital gains deduction only applicable to Stock Option Plans

The 50% deduction (33.33% deduction from June 25, 2024 and onwards) is not reported in Code 39 (code 92 from June 25, 2024 and onwards) of the T4 slip, nor is the 25% deduction reported in Code L-9 (Code L-12 from June 25, 2024 and onwards) of the RL-1 for ESPPs or stock bonus plans, as the benefit is not based on an agreement between the employer and the employee that allows the employee to purchase shares at a fixed per-share price in the same way as with stock option plans.

The information above provides a brief overview and explanation of how these benefits are handled.

2. **When an employee donates qualifying securities (public) to charity, the employer reports the benefit amount in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) of the T4 slip. Instead of a 50% deduction in Code 39 (33.33% deduction in Code 91 from June 25, 2024 and onwards), does the employer report a 100% deduction, or does the employer report a 50% deduction in Code 39 (33.33% deduction in Code 91 from June 25, 2024 and onwards), and the employee receives a receipt for the securities when they file their personal tax return? Would it be the same for the RL-1?**

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The employer would only report the 110(1)(*d*) or (*d*.1) deduction under Code 39 of the T4 slip and Code L-9 of the RL-1 (code 91 of the T4 slip and Code L-12 of the RL-1 from June 25, 2024 and onwards). The employee would be entitled to claim a deduction of 50% (33.33 % from June 25, 2024 and onwards) of the benefit plus an additional benefit when they file their respective personal tax returns, provided the donated securities had not decreased in value. The employee should receive a receipt from the charity, or if the employer arranged the donation, the employer could report the donation on the T4 slip in Box 46 and Box N of the RL-1.

Gifts of securities acquired under a security option plan

You can claim an additional deduction on your personal tax return for donating publicly listed shares of corporations or mutual fund units you acquired through your employer's security option plan. However, you must meet all of the following conditions:

- You acquired security under an option that was granted to you as an employee of a corporation or mutual fund trust.
- You disposed of the security in the year it was acquired and not more than 30 days after its acquisition by donating it to a qualified donee that is not a private foundation.

3. **An individual exercises stock options and has also completed a CPT30** Election to Stop Contributing to the Canada Pension Plan, or Revocation of a Prior Election **form to stop CPP deductions. This individual has no other income to be reported on their T4 slip.**

Please confirm that the benefit should be reported on the T4 slip as follows:

- **taxable benefit from the stock option (Boxes 14 and Code 38 (Code 90 from June 25, 2024 and onwards),**
- **the tax deducted (Box 22); and**
- **the 50% (33.33% from June 25, 2024 and onwards) deductible (Code 39) (code 91 from June 25, 2024 and onwards), which we have confirmed, should be reported in our company’s particular situation.**

Per the CRA’s instructions, we are to leave Box 28 empty and not put an “X” since the earnings are not exempt; they are only excluded from pensionable earnings.

Our system considers these earnings pensionable and will create an amount in Box 26. Will these individuals appear on the PIER report, and will a copy of the CPT30 suffice as a backup for the reason for no CPP deductions?

If the employee does not have any CPP amounts deducted from their pay, Box 26 pensionable earnings should not have any amounts reported that pertain to pay dates after which the employee has filed an election by completing a CPT30 form requesting that the employee not have any CPP deducted if they have reached the age of 65. As a result of the fact that there were no CPP deductions taken, this should be reflected in Box 26 of the T4 slip.

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4. **An individual exercises stock options where we deducted CPP. Later in the year, they completed a CPT30 form and exercised another stock option where we did not take CPP. Besides manually overriding Box 26 to show only the "pensionable" portion of the exercise from the first transaction, is there another way of avoiding a PIER report in this type of situation? I assume the CRA will report these individuals on the PIER and that we will again need to provide a copy of the election notice.**

   You would report the earnings as with the example above and include the amount taken from question 3 first exercise for CPP in Box 16.

   The amounts reported in Box 26 of the T4 slip should only reflect the pensionable earnings for which CPP deductions have been taken.

5. **I have a question relating to stock option benefits arising from the death of an employee.**

   Where an employee holds unexercised stock options at the time of death, paragraph 7(1)(*e*) of the *Income Tax Act* deems the employee to have received an employment benefit in the year of death equal to the amount by which the value of the stock options immediately after death exceeds the amount, if any, paid by the employee to acquire the options. When an option provides that it is automatically canceled on an employee's death, its value immediately after death would be nil, and no amount is included in the deceased's income under paragraph 7(1)(*e*). However, if the terms of the options provide that the estate may exercise the options for a limited period following the employee's death, paragraph 7(1)(*e*) may result in an income inclusion for the employee.

   Please discuss how the stock option benefit arising on death is reported for both federal and Québec tax purposes. Also, for stock options of public corporations that would generally qualify for the paragraph 110(1)(*d*) tax deduction had the employee exercised stock options before death, does the same apply where an employee dies holding unexercised options and is deemed to have received a taxable benefit on death in circumstances where paragraph 7(1)(*e*) applies? Does the employer report a paragraph 110(1)(*d*) deduction amount on the T4 slip for the deceased employee in addition to the stock option benefit amount that arises on death?

   An internal CRA technical interpretation (TI) confirms that an employee who holds unexercised employee stock options at the time of death is deemed to have received a benefit in the year of death equal to the stock options' value immediately after death, net of their cost of acquisition (TI 2009-0327221I7, December 21, 2012). The deceased's estate is deemed to have acquired the options at a price equal to their fair market value.

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Employer Reporting Requirements
When an employee holds unexercised employee stock options at the time of death, under paragraph 7(1)(*e*) of the *Income Tax Act*, they are deemed to have received an employment benefit in the year of death equal to the options' value immediately after death less any amount that they paid to acquire them. (Paragraphs 7(1)(*b*), (*c*), and (*d*) of the stock option rules do not apply if paragraph 7(1)(*e*) applies.)
When an option provides that it is automatically canceled on an employee's death, its value immediately after death is nil, and no amount is included in the deceased's income under paragraphs 6(1)(*a*) and 7(1)(*e*).
However, if the option's terms provide that the estate may exercise the option for a limited period—one year after the employee's death—then paragraph 7(1)(*e*) may result in an income inclusion for the employee.
The TI states that if a deceased's estate receives an employee stock option, generally, paragraph 69(1)(*c*) deems its added cost base (ACB) to the estate to be its fair market value at the time that the estate acquires it. (That ACB is reduced under paragraphs 53(2)(*t*) and 164(6.1)(*b*) by the subsection 164(6.1) loss if any.)
In general, if an estate exercises an employee stock option, its ACB is added to the cost of the shares (subparagraph 49(3)(*b*)(ii)).
The CRA says that an option may decline in value after the taxpayer's death, and then the benefit realized by the estate on its exercise or disposition is less than the benefit that must be reported by the deceased under paragraph 7(1)(*e*). Subsection 164(6.1) can provide relief if the option is exercised, expires, or is otherwise disposed of within the estate's first taxation year. If the legal representative elects in the prescribed manner, the loss is deemed to be a loss from the deceased's employment for the year of death. The loss amount (paragraph 164(6.1)(*a*)) equals the amount of the benefit deemed received by the deceased in the year of death under paragraph 7(1)(*e*) minus the option's value immediately before its exercise or disposition, net any amount that the deceased paid to acquire the option. If one-half of the option benefit was deducted under paragraph 110(1)(*d*) vis-à-vis the deceased's income inclusion in the year of death under paragraph 7(1)(*e*), the loss carryback is reduced by paragraph 110(1)(*d*) deduction.

In the year of death, an employer must report the amount of the employment benefit, calculated under paragraph 7(1)(*e*), on the appropriate information return (form T4 or T4A) in the deceased employee's name.

It is recommended that you validate the information in your plan documents and seek legal counsel on such payments.

Revenu Québec similarly treats security options with one exception. The stock option benefit must be reported on the RL-1 in Boxes A and L as well as using Code L-7. Code L-7 is meant to record the amount of the security option when an employee is deceased. There would not be any 25% deduction recorded on the RL-1 as there would be on the T4 slip.

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6. **I'm wondering how people should typically manage the taxable benefit component of stock options when they are received part-way through the year or at the end of the tax year. How do you collect taxes owed?**

   The employer is responsible for collecting the federal and provincial income taxes as well as the C/QPP contributions at the time the employee exercises their options and acquires the shares. It does not matter if the employee sells the shares or not. Security option benefits are no different from any other taxable benefit. The employer is responsible for collecting and remitting the source deductions when the employee enjoys the benefit. The process is the same no matter what time of the year the employee exercises their options.

7. **Withholding for contractors/self-employed stock option exercises:**
   a) **For contractors/self-employed who are not part of our payroll, are we required to withhold C/QPP on option exercises?**
   b) **Can we use a tax percentage provided by the contractor in calculating the tax withholding (as we don't know their annual taxable income to determine their rate)?**

   As previously discussed, a contractor/self-employed individual who is not an employee but receiving stock options should not have the options reported as employment income on the T4 slip. The total amount should be reported on a T4A slip in Box 048.

   The amount reported is considered business income in the year of the grant, and the value is the fair market value of the security at the time of the grant, less any amount paid by the contractor for the options. There would not be any paragraph 110(1)(*d*) deduction since the contractor/self-employed presumably paid nothing for the options.

   As a result of the fact that the securities are not considered to be employment income when provided to self-employed/contractors and the amounts are reported as "fees for services" in Box 048 of the T4A slip, there is no requirement to withhold C/QPP or income tax.

8. **Could you give us some information on Restricted Stock Awards/Grants and how they should be handled from a payroll standpoint?**

   Usually, Restricted Stock Awards/Grants consist of free shares. These free shares become a taxable benefit at the time of acquisition when employees receive the shares. The stocks are also known as Stock Bonus Plans or Restricted Share Units.

   They are subject to C/QPP and income tax, which is calculated using the bonus method of taxation at the time of acquisition. The shares are reported in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) of the T4 and Boxes A and L of the RL-1. These shares would not be allowed a 50/25% (33.33/25%) capital gains deduction, nor have Code 39 (code 91 from June 25, 2024 and onwards) be reported on the T4 slip or Code L-9 on the RL-1 (Code L-12 from June 25, 2024 and onwards) .

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9. **When security options are granted from a parent company not resident in Canada to Canadian residents, how should the foreign exchange be handled when computing the taxable benefit? For instance, should the exchange rate be established based on the date of exercise, date of notification, and date of actual transfer of funds, or is this legislated or applied in accordance with best practices?**

   There are no clear instructions in this area. The best practice employers should consider to be fair and equitable is to use the exchange rate in effect on the date of the share acquisition. Employers can access these exchange rates on the Bank of Canada's website.

10. **Who reports/deducts taxes on stock exercises if that person no longer resides in the country where they were granted the options? For example, we have many employees who transfer between countries. They are granted the options while in one country and then exercise them in another country, or vice versa. I have been told that if that employee now resides in Canada, the benefit is to be reported on the T4 slip, and they should be taxed on that benefit even though that benefit may have been granted while they worked in the U.K., for example.**

    On the flip side, we have employees who have been granted options while in Canada and have since transferred to our U.S. office, and they have exercised while on the U.S. payroll. We could report the benefit on a Canadian T4 slip, but the taxes must be withheld from the U.S. payroll.

    Suppose the stock options are granted by a Canadian company. In that case, they have to be reported by the Canadian corporation on a T4 slip when they are exercised, regardless of where the employee or former employee resides at the time of exercise or where the services were performed.

    This is because stock options are subject to withholding under subsection 153(1) of the *Income Tax Act*. Therefore, the payer (employer) must prepare an information return under Regulation 200 of the Income Tax Regulations.

    If the income from a stock option benefit is not sourced to Canada, i.e., taxed in Canada, withholding tax is not required. If the options were received by virtue of the employee's employment in Canada, the employer is required to withhold income tax and C/QPP when the employee acquires the shares.

    If the services were not performed in Canada and the employee was not a resident of Canada, subsection 104(2) of the Regulations states that "no amount shall be deducted or withheld." However, a T4 slip is still required.

    Where the taxable benefit is for a non-resident, the withholding should be calculated as if the employee were a resident. In addition, the employer can take into consideration the paragraph 110(1)(*d*) or (*d*.1) deduction if the employee is eligible to reduce the amount subject to tax. This would be the case if the employee is no longer employed with the organization and is either a Canadian or a non-resident. As a result of the fact that the option exercise is attributed solely by virtue of the employee's employment in Canada, the employer is responsible for calculating and remitting source deductions as usual, although the employee may no longer be resident in Canada.

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If the employee is still employed by the overall organization and is granted the options in Canada, the portion of the exercise representing the period the employee is in Canada is exercised in Canada, and the period the employee is in the other country is exercised in that country. For example, the employee in question has been employed with the organization for three years. The employee was employed in Canada for the first two years and the other year in the U.S. The employer would report two-thirds of the option benefit value in Canada and the other one-third in the U.S.

Finally, all employees who choose to purchase the public securities in the new organization for the 25% discount are subject to a taxable benefit equal to the amount of the discount that is reported on the T4 slip in Box 14 and Code 38 (Code 90 from June 25, 2024 and onwards) and Boxes A and L of the RL-1. No deduction would be reported on the T4 slip or RL-1, as the employees did not acquire the shares based on a fair market value share price on a specific date in an employee-employer contract, which is required for the deduction to be reported on the T4 slip.

11. **Our company is re-purchasing the stock option in 2023 (not a Canadian-controlled private corporation), which was already exercised by a former employee in 2021. The employee reported a 50% deduction in 2021 and paid taxes in 2021. Does the employer require any adjustment or reporting in 2023?**

    Provided that the employee acquired the shares (in 2021) under a security options agreement as non-CCPC shares, the income inclusion from exercising the option would have taken place in 2021. All required withholding (CPP, income tax) should have occurred at that point and been reported as part of the company's T4 slip filing.

    If the statutory withholdings were made when the option was exercised, the 2023 buy-back (at the same price as the exercised price) by the employer would not trigger any statutory withholdings. The transaction should be treated as a usual commercial transaction whereby reporting any capital gain or loss on the transaction would be the seller's responsibility (in this case, the former employee).

REFERENCES: CANADA REVENUE AGENCY

Income Tax Act

Income Tax Regulations

T4130 Employers' Guide – Taxable Benefits and Allowances

Security options

RC4120 Employers' Guide – Filing the T4 Slip and Summary

T4037 Capital Gains

IT-113R4 – Benefits to Employees – Stock Options

IC89-3 Policy Statement on Business Equity Valuations

REFERENCES: REVENU QUÉBEC

Québec Taxation Act

Regulation respecting the Taxation Act

IN-253-V – Taxable Benefits

RL-1.G-V – Guide to Filing the RL-1 Slip: Employment and Other Income

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FEEDBACK

The National Payroll Institute appreciates your comments and welcomes your suggestions as we seek to continually improve our member resources. Please direct any feedback on these guidelines to:

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ACKNOWLEDGEMENTS

The National Payroll Institute would like to thank Joseph McNamara, PLP, and Tina Beauchamp, PLP, and Compliance Services staff, who provided content and feedback to develop *Taking Stock of Your Options*, first edition.

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APPENDIX

FEDERAL CHANGES TO EMPLOYEE STOCK OPTIONS

On June 17, 2019, federal Finance Minister Bill Morneau tabled a Notice of Ways and Means Motion that contained proposed changes to the tax treatment of employee stock options initially announced in the March 19, 2019, Federal Budget. The Notice of Ways and Means Motion outlines the various provisions that will be contained in the new structure for stock options. At that time, the provisions were scheduled to come into effect on January 1, 2020

On November 30, 2020, Chrystia Freeland, Minister of Finance and Deputy Prime Minister of Canada, presented the Fall Economic Update that included the following changes related to stock options which provided additional clarification and delayed the implementation date to July 1, 2021.

The new measures came into force effective July 1, 2021, with the passing of Bill C-30, *An Act to implement certain provisions of the budget tabled in Parliament on April 19, 2021, and other measures.*

New Tax Rules

Employers Subject to the New Tax Rules
The new rules would apply to employers that are corporations or mutual fund trusts. Employers that are Canadian-controlled private corporations (CCPCs) would generally not be subject to the new rules.

Further, in recognition that some non-CCPCs could be start-ups, emerging or scale-up companies, non-CCPC employers whose annual gross revenue does not exceed $500 million would generally not be subject to the new rules.

$200,000 Limit

A $200,000 limit will apply on the amount of employee stock options that may vest in an employee in a calendar year and continue to qualify for the stock option deduction. For the $200,000 limit, the amount of employee stock options that may vest in any calendar year would be considered equal to the fair market value of the underlying shares at the time the options are granted.

An option vests when it first becomes exercisable. The determination of when options vest would be made when the option is granted. If the year in which the option vests is unclear, the option would be considered to vest on a pro-rata basis over the term of the agreement, up to five years.

The $200,000 limit on the amount of employee stock options that may vest in any calendar year and qualify for the stock option deduction would generally apply to all stock option agreements between the employee and the employer or any corporation that does not deal at arm's length with the employer. If an individual has two or more employers that deal at arm's length with each other, the individual would have a separate $200,000 limit for each of those employers.

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Employee Tax Treatment

When an employee exercises an employee stock option that exceeds the $200,000 limit, the difference between the fair market value of the share at the time the option is exercised and the amount paid by the employee to acquire the share would be treated as a taxable employment benefit. The total amount of the employment benefit would be included in the employee's income for the year the option is exercised, consistent with the treatment of other forms of employment income. The employee would not be entitled to the stock option deduction for this employment benefit.

For employee stock options over the $200,000 limit, the employer would be entitled to an income tax deduction for the stock option benefit included in the employee's income. The deduction may be claimed in the employer's taxation year, including the day on which the employee exercised the stock option.

Employers subject to the new rules must ensure compliance concerning the $200,000 limit. This would include a requirement that an employer notifies employees in writing whether options granted are subject to the new tax treatment. In addition, employers would be required to notify the Canada Revenue Agency if the options granted are subject to the new tax treatment.

Effective date July 1, 2021

The change applies to all stock options granted on or after July 1, 2021. Options granted (regardless of vesting or exercise) up to and including June 30, 2021, will be subject to the previous legislation.

Coming into Force

The new tax rules apply to employee stock options granted after June 2021. The existing rules would continue to apply to options granted before July 2021 (including qualifying options granted after June 2021 that replace options granted before July 2021).

Additional details on the above initiatives will be made available when they become available.

Canadian-controlled private corporations (CCPCs) and other types

These changes do not impact options granted by CCPCs. In addition, these changes will not affect other share types that are not entitled to a deduction. These include:

- Stock bonus plans AKA (Restricted Share Units, Deferred Share Units, or additional similar description).
- Employees share purchase plans. Employees receive shares at a reduced price once these terms are defined.

Definitions for Organizational Terminology

The definition of a large organization would include a non CCPC organization with revenues of $500 million or more.

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Summary of important facts

i. The security option changes do not apply to non-Canadian-controlled private corporations with gross revenues of $500 million or less and Canadian-controlled private corporations;
ii. the security option changes only apply to agreements to issue securities entered into on or after July 1, 2021. They also do not apply to new options which were acquired in exchange for options issued before July 2021;
iii. the $200,000 vesting limit per calendar year is determined by the FMV of the underlying shares when the options were granted, not by the taxable benefit received from the shares;
iv. for any security options beyond the $200,000 vesting limit where the changes are applicable, notice must be provided to the employee by the employer no later than 30 days after the agreement;
v. for any security options beyond the $200,000 vesting limit, the deduction under 110(1)(d) will not be available for employees, but the deduction under 110(1)(e) will be allowed for employers; and,

1. There are no plans for any other reporting of revenues relating to the security option changes other than the T2 return, and a prescribed form is in development to report the security option amounts. There will be no changes to the T4 slip. As the legislation is not yet complete, the nature of the prescribed form is not entirely certain. Once we have the prescribed form, we will advise accordingly.

2. A As the revenues of the non-CCPC are below the threshold of $500 million in any of the three scenarios presented.

2. Here are the required security option payroll reporting: (Box 14, Codes 38 and 39), (Box 14. Codes 90 and 91 from June 25, 2024 and onwards). The new security options policy will not apply to them unless their gross revenues should rise above $500 million. The total stock option benefit will be reported in Code 38 (Code 90 from June 25, 2024 and onwards), with 50% of that amount reported in Code 39 (33.33% of the amount reported in Code 91 from June 25, 2024 and onwards). The amount reported in Code 38 (code 90 from June 25, 2024 and onwards) will also be included in Box 14.

2. B As the revenues of the non-CCPC are above the threshold of $500 million, the new security options rules would apply if the security options were granted after June 2021. The amount that will qualify for the security options deduction will be determined based on the FMV of the shares when they were granted. We would need further information to answer the question, mainly when the options were granted and when they had vested were not provided.

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