Tax Law

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Proposed Changes to Tax Treatment of Stock Options Under New Liberal Government

On November 4, 2015, Liberal leader Justin Trudeau was sworn in as Canada's 23rd prime minister. Canadians can expect a number of significant tax changes under the new Liberal government. One change that relates to the tax treatment of stock options likely will adversely affect a significant number of executives.

Current Tax Treatment

Under existing tax laws, a benefit realized by an employee on the exercise or cashing out of stock options is treated as employment income but in many cases is eligible for a 50% stock option deduction, resulting in taxation at rates similar to those applicable to capital gains. The original rationale for treating stock options like capital gains was to encourage more widespread use of employee stock option plans, which were thought to promote greater employee participation and increase productivity.

Proposed Changes

In its 2015 election platform, the Liberal Party announced an intention to cap how much can be claimed under the 50% stock option deduction described above. Acknowledging that employee stock option plans are useful compensation tools for start-up companies, the Liberal government's proposal is to ensure that employees with up to $100,000 of annual stock option income will be unaffected by the cap.

Uncertainties Under the Proposed Changes

There are a number of uncertainties under the proposed changes, which will not be clarified until draft legislation is released:

- *The $100,000 Cap*. It is unclear whether executives who realize annual stock option income in excess of $100,000 will be entitled to claim the 50% stock option deduction in respect of the first $100,000 of income, or whether such executives will be completely barred from claiming the deduction.
- *Timing of Changes*. While we continue to watch for developments relating to the proposed changes, there is presently no information on when the proposed changes will be announced by the new government or when they will take effect. It is possible that the proposed changes will be effective retroactively as of the announcement date, and that existing stock option holders will not benefit from grandfathering or transitional rules.
- *Scope of Changes (CCPCs)*. Under the current rules, additional tax advantages may be enjoyed by executives who exercise options to acquire shares of Canadian-controlled private corporations. It is unclear whether these advantages will be affected by the proposed changes.

What Can You Do Now?

If enacted as currently proposed, the proposed changes to the tax treatment of stock options likely will create a significant incremental tax burden for executives that participate in employee stock option plans. This cost may be exacerbated by the proposed increase to the top federal marginal tax rate to 33% for individuals earning over $200,000 a year. For example, based on 2015 rates, an Ontario stock option holder may be subject to tax on stock option income at tax rates in excess of 53%. In light of the foregoing, we recommend that employers with employee stock option plans discuss the proposed changes with affected employees at their earliest opportunity.

If you wish to discuss these matters further, including possible strategies to take advantage of the current 50% stock option deduction before the proposed changes are implemented, please contact any member of our Tax Group.