



Meridian Compensation Partners

Client Update

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UPDATE: New Tax Rules for Stock Options

As part of the federal government's Fall Economic Statement, the Department of Finance announced a new implementation date for the planned change to the taxation of stock option gains, and clarified who will continue to be eligible for effective capital gains tax rates on the exercise of options.

As discussed in earlier Meridian client updates (available [June 2019 here](#), and [March 2019 here](#)), the federal government announced in 2019 a planned change to the tax treatment of stock option gains. The initial proposal eliminated the effective capital gains tax treatment on stock option gains, for *most* option awards at *most* companies, resulting in those option gains being subject to ordinary income tax rates. The main outstanding issue was how the government would define "start-up, emerging, and scale-up" companies, which would still be eligible for the existing effective capital gains treatment. In late 2019, the Department of Finance delayed the implementation date for the new stock option tax rules.

The federal government has now proposed the following:

- The new tax rules will take effect for **grants made on or after July 1, 2021**. Grants made before that time will be subject to the existing rules and continue to be eligible for effective capital gains treatment.
- The existing effective capital gains treatment will also remain in place for stock options granted at companies with **annual gross revenues of \$500 million or less at the time of grant (i.e., companies that are "start-ups, emerging or scale-up companies")**. The revenue limit is applied on an annual basis, and for an employer that is a member of a corporate group, at the highest level of consolidation, and is based on the last annual financial statements presented to shareholder.

Meridian Comment: The new proposals are similar to the 2019 draft legislation, but now provide much needed clarification on the main outstanding issue.

Consistent with the prior announced changes, up to \$200,000 of stock option value that **vests** each year will continue to be eligible for effective capital gains tax rates, with the value determined based on the fair market value of the underlying shares at grant. In a clarification from the prior changes, if no vesting year is specified, the option is deemed to vest ratably over its term, up to a 5-year period. The introduction of an employer deduction and the ability for a company to designate a stock option as "non-qualified" remains largely unchanged, and Canadian Controlled Private Corporations (CCPCs) will continue to be subject to the existing tax rules.

We continue to expect that, in light of the proposed changes, companies subject to the new tax rules will review their long-term incentive designs and vehicle mixes.

Companies subject to the new rules should start to put in place a system to track the annual vesting amounts of employee stock options. Companies relying on the gross revenue test will need to confirm each year whether they will be subject to the new rules.

The new implementation date means that many calendar year end companies will not need to consider accelerating their 2021 equity award timing ahead of the in-force date.

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