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Association du Barreau canadien

et

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Le 13 septembre 2019

Monsieur Ted Cook
Directeur général
Division de la législation de l'impôt
Direction de la politique de l'impôt
Ministère des Finances
90, rue Elgin
Ottawa (Ontario) K1A 0G5

Objet : Modifications de l'option d'achat d'actions accordée à des employés

Monsieur,

Dans l'avis de motion de voies et moyens pour la modification de la *Loi de l'impôt sur le revenu* du Canada (la **« *Loi* »**)[1] déposé par le ministre des Finances le 17 juin 2019 (l'**« avis »**), le gouvernement a présenté des propositions législatives (l'**« avant-projet de loi »**) qui auraient pour effet de modifier les règles de l'option d'achat d'actions accordée à des employés, comme le veulent les propositions initialement annoncées dans le budget de 2019. Nous avons fait connaître nos premières observations sur ces propositions initiales dans notre mémoire daté du 14 mai 2019. Dans le présent mémoire, notre intention est de commenter certains points techniques de l'avant-projet de loi.

Après un examen attentif de cet avant-projet, les membres du Comité mixte ont discuté de certaines questions techniques avec le ministère des Finances. Dans le mémoire (uniquement en anglais) qui suit, nous présentons nos observations et recommandons de possibles changements à l'avant-projet de loi.

Comme il a été dit dans nos discussions, notre mémoire ne renferme aucune observation sur les conditions prescrites dont il faudrait assortir ces propositions afin de déterminer quelles entreprises

[1] Sauf indication contraire, tous les renvois législatifs dans le présent mémoire concernent la *Loi.*

seraient exemptées des modifications projetées. Dans notre mémoire du 14 mai 2019, nous avons présenté des commentaires généraux sur

entreprise canadienne en croissance rapide ; à l'heure actuelle, nous n'avons rien à ajouter, mais nous serons heureux de discuter des méthodes précises que le Ministère envisage.

Des membres du Comité mixte ainsi que d'autres intervenants du secteur fiscal, énumérés ci-dessous, ont participé à la discussion concernant ce mémoire et ont contribué à sa rédaction.

- Bruce Ball – CPA Canada
- Marlene Cepparo – KPMG Canada
- Ian Crosbie – Davies Ward Philips & Vineberg
- Ken Griffin – PwC Canada
- Kim Moody – Moody's Gartner Tax Law
- Angelo Nikolakakis – EY Cabinet d'avocats s.r.l./S.E.N.C.R.L.
- Michael Royal – Goodmans LLP
- Michael Saxe – MNP s.r.l./S.E.N.C.R.L.
- Carrie Smit – Goodmans LLP
- Anthony Strawson – Felesky Flynn LLP
- Jeffrey Trossman – Blakes, Cassels & Graydon s.r.l./S.E.N.C.R.L.

Nous avons bon espoir que notre mémoire vous sera utile, et serons heureux d'en discuter plus en détail au moment qui vous conviendra.

Veuillez agréer, Monsieur, l'expression de nos sentiments les meilleurs,

Ken Griffin
Président, Comité sur la fiscalité
Comptables professionnels agréés du Canada

Angelo Nikolakakis
Président, Section du droit fiscal
Association du Barreau canadien

Submission Respecting the Notice of Ways and Means Motion dated June 17, 2019

Broadly speaking, the Draft Legislation seeks to (i) deny the deduction under paragraph 110(1)(d) in respect of benefits deemed by subsection 7(1) to have been received in respect of a "non-qualified security"; and (ii) permit an employer to deduct an amount in computing its taxable income equal to the benefit deemed by subsection 7(1) to have been received by an individual in respect of a "non-qualified security".

While the relevant statutory provisions refer to an "agreement" to sell or issue securities, such agreements are frequently in the form of employee stock options. For ease of reference, we will refer in some instances to "options" being "granted" as equivalent to "agreements" being "entered into".

Members of the Joint Committee and others in the tax community have reviewed the Draft Legislation and have the following observations and recommendations.

1. Application of Draft Legislation

The two key operative provisions in the Draft Legislation are (i) the change to paragraph 110(1)(d) to deny the 50% deduction where the underlying security is a "non-qualified security", and (ii) the addition of new paragraph 110(1)(e) to permit the employer to deduct an amount equal to the subsection 7(1) benefit in certain circumstances where the underlying security is a "non-qualified security". The former provision is in subsection (2) of the Notice and the latter change is in subsection (3). The Notice provides that subsection (2) will "come into force or [be] deemed to come into force on January 1, 2020"; in contrast, subsection (3) will "apply in respect of agreements to sell or issue securities entered into after 2019". Thus, the coming-into-force provisions for the rule that denies a benefit differs from that applicable to the corresponding relieving rule.

We consider this asymmetry to be inappropriate. While it is true that the definition of a non-qualified security appears to apply only in respect of agreements entered into after 2019, we can discern no good reason for having different coming-into-force provisions for the two rules, and are concerned that currently unforeseeable anomalies could result from such an approach. The coming-into-force provision for the two key operative provisions should, in our view, be identical in order to preclude any possibility that the 50% deduction could be denied to an optionholder under the new regime in circumstances where the employer is disentitled to a corresponding deduction. We therefore recommend as follows:

Recommendation

The coming-into-force provisions should be modified to clarify that both subsections (2) and (3) apply only in respect of agreements to sell or issue securities entered into after 2019.

We are also concerned that the coming-into-force provisions need to more appropriately address situations in which options are exchanged or repriced. It is common in the context of an acquisition

or reorganization transaction to exchange existing options for new options on a tax-deferred basis under subsection 7(1.4). It is also common in the context of an option repricing (where the fair market value of the underlying security has decreased since the time the related option was granted) to either exchange an existing option for a new option under subsection 7(1.4), or simply reprice (without exchanging) the existing option in reliance upon subsection 110(1.7) to deem the existing option to have been exchanged for a new option.

Where subsection 7(1.4) applies, paragraph 7(1.4)(e) deems the new option to be the same option as, and a continuation of, the exchanged option, but this continuity rule applies only for purposes of section 7; it does not apply for the purposes of section 110. This leaves open the possibility that the operative provisions in the Draft Legislation (which we understand are intended to apply only to options granted after 2019) may inadvertently apply to a new option granted (or deemed to be granted under subsection 110(1.7)) on an option exchange (or repricing) or other amendment undertaken after 2019, even where the existing option was granted prior to 2020 and would not have been subject to the Draft Legislation.

Recommendation

The measures in the Draft Legislation should apply only in respect of an agreement to sell or issue securities entered into after 2019, other than an agreement to sell or issue securities entered into after 2019 as consideration for the disposition of another agreement to sell or issue securities to which the Draft Legislation does not apply, where subsection 7(1.4) applies to such exchange of options.

The coming-into-force provisions and the Explanatory Notes should also clarify that a repricing of options to which subsection 110(1.7) applies, where the original options were not subject to the Draft Legislation, does not result in a new agreement that would be subject to the Draft Legislation.

2. <u>Employer Deduction</u>

The Draft Legislation proposes to introduce paragraph 110(1)(e) to permit a deduction to be claimed in computing taxable income by, generally speaking, the relevant employer entity in circumstances where the 50% deduction is denied to the optionholder by virtue of the new exclusion for options in respect of non-qualified securities. We understand that the deduction was intentionally structured as a deduction in computing taxable income (as opposed to income) in order to make it clear that this deduction is unaffected by paragraph 7(3)(b), which generally denies the employer or issuer a deduction in computing income when an option governed by section 7 is physically exercised.

However, we have identified a number of technical problems relating to the deduction contemplated by proposed paragraph 110(1)(e).

(a) Conditions for Deduction

Subject to a long list of conditions, paragraph 110(1)(e) permits a particular taxpayer to claim a deduction in computing taxable income for a particular taxation year in respect of a benefit deemed to have been realized under subsection 7(1) by an individual in the year.

These conditions, each of which must be met for the deduction to be available, are as follows:

(i) Pursuant to the preamble, the particular taxpayer must be the entity that has agreed to sell or issue securities. In other words, it must be the issuer of the employee stock option. In many organizations, this would typically be the parent corporation or trust, which may or may not be resident in Canada, and may or may not be the entity that employed the optionholder at the time of either grant or exercise.

(ii) The particular taxpayer must be a "specified person", meaning a corporation or mutual fund trust that is neither a Canadian-controlled private corporation ("**CCPC**") nor an entity that meets prescribed conditions (under the regulations to be promulgated to specify entities to be exempted from the new regime) (referred to herein as "**exempt entities**"). The Draft Legislation does not specify precisely when the particular taxpayer must meet this condition.

(iii) The particular taxpayer must have been "the employer of the individual" at the time the agreement was entered into, i.e., the time of grant of the option.

(iv) It must be the case that the individual would have been entitled to the 50% deduction under paragraph 110(1)(d) if the underlying security had not been a non-qualified security. This means that if the 50% deduction would otherwise have been denied, for example in a situation where the issuer was a CCPC but the optionholder does not deal at arm's length with the issuer, where the underlying share is not a prescribed share, or where the option was "in-the-money" when granted, the particular taxpayer may not deduct any amount even though the individual is ineligible for the 50% deduction.

(v) The notification provisions in proposed subsection 110(1.9) must be met.[2]

The following are our comments on these conditions.

[2] As discussed below, the notification requirements may not be able to be satisfied in all situations.

(b) Issuer may not be the employer

The conditions for the deduction presume that the particular entity that employs the individual at the time of grant is the entity that has agreed to sell or issue securities. In fact, it is common in corporate groups for the issuer of an option – which would normally be the entity that agrees to sell or issue securities - to differ from the entity that employs the individual at the time of grant.

We understand it is intended that the deduction be available to "the employer" of the individual, and there is certainly some logic to that result. At the same time, it is self-evident that a deduction should not be unavailable simply because the employer differs from the issuer.[3] This potential anomaly should be fixed.

Recommendation

Proposed paragraph 110(1)(e) should be amended by permitting the deduction to be claimed by a particular taxpayer that employed the individual at the time the agreement to sell or issue securities was entered into (the "grant time"), where that agreement was entered into either by the particular taxpayer itself, or by a qualifying person that did not deal at arm's length with the particular taxpayer at the grant time.

(c) Employer should not be required to be a "specified person"

Consistent with the above comments, it is common in corporate groups for employee stock options to be issued by the "parent" company – which may be domestic or foreign – where individuals are employed by one or more operating subsidiaries. Similarly, in the context of some businesses conducted by mutual fund trusts, such as real estate investment trusts ("**REITs**"), employees may be employed by a corporation, trust or partnership that is in the group, but that is not the parent entity.

The "specified person" definition excludes from its ambit any CCPCs and exempt entities. This makes sense when describing the parent entity in the group, as the "non-qualified security" definition refers to the "specified person" as the entity that agrees to sell or issue securities, i.e., typically the parent entity. What does not make sense is for the deduction to be denied to a particular entity that employed an individual simply because that particular entity is not itself a "specified person", either at the time of grant or at the time of exercise. The conditions to be met for a deduction to be claimed should be made more flexible in order to avoid disentitling an employer to an otherwise available deduction solely because that entity is not a specified person, for example, where that entity is a trust that is not a mutual fund trust.

[3] The Explanatory Notes to draft paragraph 110(1)(e) acknowledge this, providing as follows: "Securities to be sold or issued under a stock option agreement can be non-qualified securities where the agreement provides that a specified person that does not deal at arm's length with the employer will sell or issue its securities to the employee. In such a circumstance, paragraph 110(1)(e) provides the deduction to the employer and not the issuer of the securities."

In many situations, the employer entity is a partnership owned by corporations and/or trusts. Partnerships generally compute and allocate income, not taxable income. Certain trusts also compute and allocate income, not taxable income. The Draft Legislation or Explanatory Notes should clarify that where individuals are employed by a partnership or a trust, the paragraph 110(1)(e) deduction is available to the partners or the beneficiaries. It would be inappropriate for an otherwise available deduction to be denied solely because the employer entity is a partnership or a trust.

Where the employer is a non-resident operating through a branch in Canada, further revisions may be needed to the definition of "taxable income earned in Canada" ("**TIEC**") in section 115 to ensure that the deduction under paragraph 110(1)(e) is taken into account in computing TIEC.

Recommendations

Proposed paragraph 110(1)(e) should be amended to require only that the entity that entered into the agreement to sell or issue securities (the "issuer"), and not necessarily the employer, be a "specified person".

The Draft Legislation or Explanatory Notes should clarify that where individuals are employed by a partnership or a trust, the paragraph 110(1)(e) deduction is available to the partners or the beneficiaries of the trust.

Paragraph 115(1)(d) should be amended to include a reference to paragraph 110(1)(e).

(d) Timing Considerations

As noted above, subparagraph 110(1)(e)(ii) requires the particular taxpayer claiming the deduction to be the individual's employer at the time the agreement was entered into, i.e., at the grant time. If the employer's business has been reorganized between the time of grant and the time of exercise, the particular entity that employed the individual at the grant time may no longer exist or carry on business at the time of exercise. This could occur where for example there has been an amalgamation of corporations, a winding-up of a corporation or partnership, or a transfer of the historical employer's business to a successor entity, such as under a subsection 85(1) rollover transaction.

Recommendation

A successor entity rule should be added so that a successor to the entity that was the employer at the grant time (including a member of a partnership where such member (or a qualifying person with which such member does not deal at arm's length) grants options to the partnership's employees), such as a corporation resulting from the amalgamation of that employer with another corporation, a parent corporation on a winding-up under subsection 88(1), a successor following a partnership wind-up

and a successor following an asset transfer under section 85 should be deemed to be the entity that was the employer at the grant time.[4]

(e) Multiple Employers

An individual optionholder may have more than one employer in a corporate or other group. For example, an individual may be a director or officer of the parent corporation or mutual fund trust, as well as an employee of a subsidiary corporation, trust or partnership. An optionholder may be employed by a partnership which has two corporate partners, where the CRA considers the optionholder to be employed by both corporate partners for purposes of the stock option rules.[5] As currently drafted, paragraph 110(1)(e) could be read as permitting *each* employer within the group to be entitled to the deduction, thereby inappropriately multiplying the deduction within the group.

Recommendation

Paragraph 110(1)(e) should include a proviso that, where an individual is employed by two or more employers that do not deal with each other at arm's length (for purposes of section 7), the employers that are resident in Canada or carrying on business in Canada may allocate the deduction between or among them, provided that the total deduction claimed by those employers in a taxation year must not exceed the total benefit that was deemed by subsection 7(1) to have been received by the individual in that year in respect of a non-qualified security.

(f) Change in Status

A specified person could cease to be a specified person after it grants an option to acquire a non-qualified security but prior to the exercise of that option. For example, a corporation that is not a CCPC at the grant time could grant an option to acquire a non-qualified security, i.e., its shares, but could then become a CCPC prior to exercise.[6] Upon exercise, the individual optionholder would not be entitled to the 50% deduction under paragraph 110(1)(d) because the grantor corporation was a specified person when the option was granted (subsection 110(1.3)(a)). In these circumstances, the grantor corporation which is now a CCPC (or relevant employer in the CCPC's group) should be entitled to a deduction under paragraph 110(1)(e). Even though the issuer may not be a specified person at the time of exercise, it was a specified person at the time of grant, with the result that the individual is denied the 50% deduction as a result of the new regime. Determining the status of the issuer at the time of grant, rather than the time of exercise, is consistent with the determination of CCPC status for purposes of subsection 7(1.1) and paragraph 110(1)(d.1), and the determination of the arm's length status of an employee seeking to claim the deduction under paragraph 110(1)(d).

[4] We note that the definition of a "successor corporation" in subsection 59(3.4) is similar to that contemplated by this recommendation.
[5] See Technical Interpretation 9604375.
[6] Similarly, a non-CCPC might not meet the prescribed conditions at the time of the grant; however, as a result of a change, it might meet those conditions at the time of exercise.

Recommendation

Subparagraph 110(1)(e)(i) should be amended so that it requires only that the relevant entity (i.e., the issuer) be a specified person at the time the agreement was entered into, i.e., the time of grant.

3. Vesting Year

The Draft Legislation introduces the definition of a "vesting year". This definition is relevant in determining which securities are non-qualified securities. In general terms, the Draft Legislation introduces a limit on the options that became exercisable in a particular vesting year which are eligible for the deduction under paragraph 110(1)(d). This limit is based on the fair market value of the securities to be issued under those options at the time of grant.

The vesting year concept presumes that an employer will know or will be able to determine, at the time an option is granted to an individual, when the individual will have the right to exercise the option and acquire the underlying securities.

Paragraph (a) of the definition of vesting year applies to securities to be issued under options which vest and become exercisable in specified calendar years. For example, this would include an option granted in Year 1, where 20% of the option may be exercised in each of the following five years (such that each of those five years would be a "vesting year" in respect of 20% of the options). However, this would not apply to rights that first become exercisable "as a consequence of an event that is not reasonably foreseeable at the time the agreement is entered into". For example, an option plan might contemplate an acceleration of vesting upon death of the grantee or a change of control of the grantor. Although neither event may be expected to occur as of the grant date, given the contemplation of those events in the plan itself, it may be uncertain whether either event was "reasonably foreseeable". It appears to us that the intention is to exclude from paragraph (a) an event that results in vesting where the timing of the event, rather than the event itself, is not reasonably foreseeable at the time of grant. However, the current language instead focuses on the foreseeability of the event itself.

Recommendation

Paragraph (a) of the definition of vesting year should be amended to exclude a right that first becomes exercisable "otherwise than as a consequence of an event the timing of which is not reasonably determinable at the time the agreement is entered into".

Paragraph (b) of the definition of vesting year applies to securities to be issued under options which vest based on other criteria, including performance metrics and liquidity events. The vesting year of a security to be acquired under such an option is the first calendar year in which the right to acquire the security can reasonably be expected to be exercised. This paragraph of the definition raises a number of concerns.

In most cases, an employee will not exercise an option and acquire the underlying security until he/she wishes to dispose of the security, regardless of when the option vests and becomes exercisable. Holding an option gives the employee the benefit of the accrual of share value without the requirement of paying for the share. The exercise of an option gives rise to the cash flow requirement to fund the exercise or strike price as well as a taxable employment benefit, which could result in immediate taxation without corresponding liquidity unless the security is sold. Further, if the security is acquired and then held by the individual, any loss realized on an eventual disposition of the security as a result of a decrease in its value will generally be a capital loss which cannot offset the earlier taxable employment benefit, potentially exposing the employee to a tax liability without any corresponding economic benefit. Thus, it may not be possible to determine the first calendar year in which the right to acquire the security can reasonably be expected to be exercised, as opposed to becoming exercisable.

In addition, the definition of vesting year presumes that, at the time an option is granted, it can be determined when the option can reasonably be expected to be exercised (or become exercisable). However, particularly in the private equity area, many options vest based on performance metrics to be achieved over a period of time or upon the occurrence of uncertain future liquidity events, including a change of control of the employer. In these circumstances, it will frequently be difficult, if not impossible, to reliably determine, in advance, when vesting may reasonably be expected to occur.

Other issues can arise under paragraph (b) of the definition of "vesting year". When an option vests based on performance metrics or a liquidity event, the vesting year of all securities to be acquired under that option may be expected to be the same calendar year. As a result, the $200,000 per vesting year limit may be exceeded, notwithstanding the fact that the option spanned many years. For example, in Year 1 an employer may grant an option to an individual to acquire 100,000 securities having an aggregate fair market value at that time of $1,000,000. Given the terms and conditions of the option, it may reasonably be expected that the right to acquire all 100,000 securities under the option will be exercised (or become exercisable) in Year 5. Accordingly, all 100,000 securities will have the same vesting year. As a result, only 20% of these options will be eligible for the deduction under paragraph 110(1)(d). If, however, the same options vested 20% per year over a 5 year period, all such options could benefit from the deduction under paragraph 110(1)(d). This appears to be an anomalous outcome, as the individual would have realized the same pre-tax economic benefit, over the same time period, in both situations.

Recommendation

Paragraph (b) of the definition of vesting year should be amended to provide that securities issuable under an option are deemed to vest ratably over the term of the option. A maximum vesting period (e.g. 5 or 10 years) could be added if there is a concern that the term of an option could be excessive.

This recommendation is intended to remove the uncertainty respecting vesting year, and to make the Draft Legislation apply more equitably by ensuring that an individual does not lose access to the deduction under paragraph 110(1)(d) simply because, for *bona fide* commercial purposes, the applicable options are reasonably expected to all vest in a single calendar year rather than ratably over the option term.

4. Annual Vesting Limit

Draft subsection 110(1.31) deems certain securities to be sold or issued under an option to be non-qualified securities. In particular, this subsection deems a proportion of securities which have the same vesting year to be non-qualified securities based on a formula. This formula gives rise to a number of issues and concerns.

(a) The Effect of Earlier Non-Qualified Securities

Subsection (ii) in the description of D in subsection 110(1.31) ("**Element (D)(ii)**") includes in the formula the fair market value of securities to be issued under earlier options, even where those securities are non-qualified securities (possibly because of a designation under subsection 110(1.4)) or are otherwise not entitled to the deduction under paragraph 110(1)(d). The inclusion of these options in the formula can inappropriately cause other securities issuable under subsequent options to be non-qualified securities (to the extent such securities have overlapping vesting years).

Recommendation

Element (D)(ii) should be revised to refer to securities to be acquired by an individual under other agreements, where the individual would be entitled to a deduction under paragraph 110(1)(d) in respect of the exercise of such other agreements.

(b) Ordering

Under the formula, the $200,000 limit is applied to the first options granted having a particular vesting year. There is no ability for the employer or the employee to apply the $200,000 limit to other options having that same vesting year.

This can cause an inappropriate denial of access to the $200,000 limit where the fair market value of an underlying security is decreasing over time. For example, assume that a public corporation issues options to an individual to acquire shares having a fair market value of $1,000,000 which vest 20% per year over the following 5 years. These options will "use up" the individual's entire annual vesting limit for that 5-year period. In Year 2, assume the corporation issues additional options to the individual when the fair market value of the shares subject to the first option has decreased. Because the corporation's share price has fallen since Year 1, the options granted in Year 2 have a lower (but still fair market value) exercise price. In Year 5, the individual only exercises the options granted in Year 2, as the corporation's share price is still less than the exercise price in respect of the Year 1 options but is higher than the exercise price in respect of the Year 2 options. Under the rigid formula in the Draft Legislation, the individual is denied a deduction under paragraph 110(1)(d) in

respect of the exercise of the Year 2 options, because the "under water" options granted in Year 1 "block" access to the $200,000 limit. Moreover, if the share price never appreciates above the exercise price in respect of the Year 1 options, the individual will never be entitled to claim a deduction under paragraph 110(1)(d) in respect of that 5-year period.[7] Indeed, this issue would appear to arise even if the options granted in Year 1 had been cancelled for no consideration prior to the exercise of the Year 2 options.

> *Recommendation*
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> *Where a subsequent option is granted to an individual by a specified person, having a lower exercise price than that of an earlier option granted by the same specified person to the same individual, the specified person should be permitted to designate the securities issuable under the earlier option to be non-qualified securities in order to permit the securities to be issued under the subsequent option not to be non-qualified securities. Subsection 110(1.9) could be revised to permit this.*
>
> *Where an option is cancelled or replaced (including by virtue of an exchange of options under subsections 7(1.4) or 110(1.7)), the securities which were to be issued under such option should be considered to be non-qualified securities and should not be options described by Element (D)(ii).*

Deferring the time by which a taxpayer is required to designate whether a particular grant of options is eligible for the deduction under paragraph 110(1)(d) would also be consistent with the timing permitted under subsection 110(1.1) in the case of a "cash-out" of options, which permits the relevant qualifying person to determine <u>at the time of exercise</u> whether to forgo a deduction in respect of the consideration paid to an optionholder in order to enable the optionholder to claim the deduction under paragraph 110(1)(d).

(c) Simultaneous Grants

If two options are granted by a specified person to an individual at the same time which vest at the same time, each such option could preclude the other option from benefitting from the deduction under paragraph 110(1)(d). This could happen, for example, where an individual is both a director and an employee and receives options in respect of each such role, or where an employee receives multiple options which vest based on time and performance (where vesting years may overlap). Element (D)(ii) inappropriately reduces the annual vesting limit where multiple option agreements with the same vesting year are entered into at the same time.

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[7] Where a corporation's share price is decreasing, the corporation might be facing liquidity constraints and therefore be more likely to grant additional options to compensate or retain its employees. It seems unfair that employees of that corporation would not be permitted to access the deduction under paragraph 110(1)(d) (for the reasons set out above) as compared to employees of a corporation that is not experiencing such difficulties.

Recommendation

Element (D)(ii) should provide ordering rules for simultaneous grants of options.

5. <u>Notification</u>

(a) Subsequent Notification

Under draft subsection 110(1.9), a specified person that agrees to issue or sell non-qualified securities to an individual must notify both the individual and the Minister of National Revenue ("**MNR**") that the securities are non-qualified securities. The notification to the individual must be given, in writing, on the day the agreement is entered into.

The requirement that the notification to the individual be given in writing on the day the agreement is entered into could lead to practical difficulties. It is often the case that an optionholder might not be informed that he/she has been granted options on the same day as the grant. For example, a board of directors might resolve to grant options at a board meeting which stretches into the evening, but only communicate this to the relevant individuals on a subsequent day. Further, individuals are often notified of a grant of options orally, via email or through other methods, with formal written documentation confirming the grant provided to the individual on a subsequent day. Requiring that written notification be provided to the optionholder on the day of grant is therefore impractical and inconsistent with commercial practice.

Recommendation

<u>Subject to the following recommendation</u>, notification to the employee should be required to be provided within 30 days of the grant of options.

Alternatively, and to facilitate the recommendation described above in section 4, it is suggested that a specified person be required only to provide this notification to the relevant employee on or prior to the exercise of the option. As discussed above, this would permit a specified person that grants a subsequent option having a lower exercise price to the same employee to designate the securities issuable under the first option as non-qualified securities. A further alternative would be to provide the notification to the employee at the earlier of (i) the day on which the option is exercised; and (ii) the filing due date for the employee's return of income for the taxation year that includes the time of grant.

Recommendation

The specified person should be permitted to notify an employee and the MNR that securities under an option are deemed to be non-qualified securities <u>after</u> the agreement has been entered into (but on or prior to the exercise).

(b) Non-Resident Grantors

Notification must also be given to the MNR, in prescribed form, with the specified person's return of income under Part I. However, many specified persons that grant options are non-residents of Canada that are not currently required to file a Canadian tax return. It is therefore recommended that such notification should instead be permitted to be made on a stand-alone basis, or perhaps in the applicable employee's T4 that would be required to be provided to the employee (either by that person or the employee's direct employer (such as within a corporate group)). This would ensure that a non-resident specified person that otherwise has no Canadian tax filing obligation will not be required to begin filing Canadian tax returns (an often very time-consuming and costly process) merely to make the notification.

Recommendation

The notification to be provided to the MNR should be able to be made on a stand-alone basis or by way of a designation (e.g., a code) in the applicable employee's T4.