# Written Submission by the Canadian Chamber of Commerce

## Consultations on Stock Options

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The Canadian Chamber of Commerce is the largest network of businesses in Canada, representing over 200,000 companies of all sizes from every sector and region of the country.

The Canadian business community supports an approach to the tax treatment of stock options that encourages investment, the attraction and retention of high-skilled talent, and the growth of innovative firms.

The public policy rationale for the preferential tax treatment of employee stock options should be to help Canadian businesses grow and compete. This certainly includes smaller, growing companies such as start-ups that do not have significant profits or reliable cash flow to attract and retain talent. This should also include other large and mature corporations engaging in major innovation and investment projects, as well as businesses that are re-structuring or having financial difficulties resulting in challenges attracting and keeping in place their management teams and their high-skilled talent.

The new rules should increase the proposed $200,000 limit and allow any unused limit to be carried over to future years. Finance Canada should consider different methods to determine the value of stock options and take into account the treatment of subsidiaries, averaging shares, and symmetry along the compensation process for all stock-based rewards.

The Canadian Chamber of Commerce sought input from businesses of all sizes and from various economic sectors and geographic regions to reach consensus on this important issue. The Canadian business community recommends that Finance Canada adopt the following principles in developing its approach.

**Principle 1: Exempt companies that are investing in growth, expansion, and re-structuring**

Small corporations developing new innovative business models – such as startup corporations – should certainly be exempt from the new stock options rules. These companies face uncertainty relating to future success and lack historic financial data or a predictable level of earnings. Startups, in particular, face unique talent acquisition challenges and often grant stock options to compete with larger corporations and foreign companies. Employee stock options are appropriate in this context as these firms have limited financial capacity to remunerate their management solely on salaries, wages, and bonuses. Many individuals that join these companies are more akin to entrepreneurs as they are taking significant risks.

However, other large and mature corporate taxpayers are also in similar situations and facing the same challenges as startup corporations. Some are investing heavily in new innovation projects that allow them to be or remain competitive in their industry and expand their business. These R&D and capital expenditures represent a significant level of investment in Canada and, if they exceed a prescribed level, then these companies should also be exempt from the new rules on employee stock options. Exemptions for these corporations should not only be tied to innovation projects, but also investment projects broadly defined.

Other large and mature businesses that are re-structuring or are having serious financial difficulties also have a justifiable need for exempt status. Stock options are a key component of these firms' remunerations plans to attract and keep management. A company whose operating cash flow has been negative for a certain number of years and other financial ratios can be used to determine companies that are exempt. In more difficult financial circumstances, these companies can be identified as those under the Bankruptcy Act or those corporations with a specified low credit rating such as junk bond status or below.

**Principle 2: Clarify how the rules will apply to avoid uncertainty**

Employers should know at the time a stock option is granted whether or not the grant will be exempt from the new annual limit. This will assist in aligning the new legislation with the requirement that employers track and monitor stock options grants. Specific rules and processes need to be in place to ensure that this determination can be done objectively by employers.

Two options exist to clarify the rules and avoid uncertainty. First, a certification process can be implemented – such as that under the Quebec Large Investment Project – whereby a corporation would be pre-approved by making a request to Finance Canada to determine whether it meets the criteria to be an excluded company.

Alternatively, specific and objective criteria can be elaborated, where one or a combination of criterion would have to be met in order to qualify. Startup corporations can be identified by having capital/equity under a certain level, companies at early stage of operations, firms with a business model under development, corporations with a forecasted exponential increase in sales volume or profitability, or those businesses with limited borrowing capacity or borrowing at high rates. For mature corporations these criteria can include: credit rating, level of R&D or capital expenditures exceeding a specific dollar amount or percentage of company financials. Export growth in excess of a specific dollar amount or as a percentage of total sales could also be considered. Finance Canada should provide clarity on how it will define a large corporation and seek feedback on this definition through the consultation process.

Any exemption status – including startup status - would, therefore, not be indefinite and would only apply as long as the corporation meets the specified criteria. All grants of stock options during the period where a corporation qualifies can be excluded from the new rules. Finance Canada can also consider requiring employees of excluded companies to keep their shares for a period of two years to be entitled to the deduction (similar to CCPCs).

**Principle 3: Increase the limit, consider how it will be determined, and permit its carry-over**

Canadian corporations must compete with other international jurisdictions to attract and retain top-level talent and compete in a global economy. Finance Canada should consider increasing the annual limit from $200,000 to $500,000 to ensure Canadian businesses have the skills needed to thrive in a transformative and increasingly competitive economy. Consideration can also be given to increasing the limit for companies that meet specified criteria if they are not exempted entirely.

Finance Canada should also consider using the value of the stock options rather than the value of the underlying shares when determining the number of stock options that qualify under the annual limit at the time the options are granted. The Black Scholes approach should be explored as a method of determining value that would make the stock options tax regime more competitive and fairer for employees. In addition, any unused annual limit should be carried over to future years, similar to the tax treatment of RRSPs and TFSAs.

**Principle 4: Encourage financial flexibility for employers**

The tax treatment of stock options has important implications for the tax competitiveness and financial options available to employers. Any new rules on the tax treatment of stock options must take into account the complexity of organizational structures and finance in today's economy. The new rules should include a provision that allows the employer deduction when a parent company grants stock options to employees of a subsidiary.

**Principle 5: Encourage consistency across the compensation continuum**

All stock-based rewards should be symmetrical by encouraging neutrality in tax deductibility along the compensation process. This principle of symmetry exists with virtually all forms of employee compensation and it is suggested that this principal be applied across all forms of compensation to increase fairness and consistency of compensation programs in all industries. In this regard, a corporate tax deduction should be permitted for all amounts that are included in an employee's taxable income whether the amount is paid in cash or corporate shares. The form of payout is often desirable for other business reasons such as employee alignment, cash flow, or a particular accounting treatment. To further increase fairness, when the fair market value of shares is included in an employee's taxable income regardless of the compensation program, those shares should be excluded from the normal adjusted cost base averaging rule if they are sold within 30 days of receipt. Often at least a portion of these shares are sold to fund withholding tax such as shares received from an employee benefit plan trust or shares issued out of Treasury.

**Conclusion**

The Canadian Chamber of Commerce would be pleased to discuss our proposals further with the Department of Finance since compensation is a significant component of attracting and retaining key talent to sustain and improve the Canadian economy.