2012-0459411C6 — ALLOCATION OF CROSS-BORDER EMPLOYEE STOCK OPTIONS

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Income Tax Act: : 448 459

Please note that the following document,
although believed to be correct at the time of issue, may not represent
the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas
représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Canada is changing its default method of allocating cross-border stock option benefits to be consistent with the OECD.

POSITION: See below

REASONS: See below

Canadian Tax Foundation
British Columbia Tax Conference
September 25, 2012

Q. 17 - Allocation of Cross-Border Employee Stock Options Benefits

Question:

To date, the Canada Revenue Agency (“CRA”) generally has presumed that an employee stock option benefit is in respect of employment exercised by the employee in the year in which the option was granted, unless there is compelling evidence to suggest the benefit is in respect of some other period. However, the tax authority of another country may consider that the benefit relates to employment exercised by the employee in another period. If the employee works partially in Canada and partially in another country during a specific period, the tax authorities in both countries may consider that the stock option benefit relates to employment exercised in their respective countries. In that case, the benefit may be taxable in both countries, with no foreign tax credit or clear relief under an income tax convention.

In July 2005, the OECD added paragraphs 12 to 12.15 to the Commentary on Article 15 [Income from Employment] of its Model Tax Convention on Income and on Capital for the treatment of cross-border stock options, with the aim of minimizing double taxation of the stock option benefit. Has the CRA adopted the principles set out in those paragraphs?

CRA Response:

OECD Commentary

Paragraphs 12 to 12.15 of the Commentary on Article 15 of the OECD Model Convention provide guidance on how to determine which country has primary taxing rights as the country of source to an employee stock option benefit. Canada has been applying the principles outlined in these paragraphs to resolve double taxation under its income tax treaties (except for the Canada-United States Tax Convention) since 2005.

Under these principles, the process of determining the amount of a stock option benefit that is derived from employment exercised in a source country is to be done by examining all relevant facts and circumstances, including any underlying contracts, as are applicable to any specific situation. In particular, a stock option benefit is apportioned to each source country based on the number of days of employment exercised in that country over the total number of days in the period during which the employment services from which the stock option is derived are exercised. In making this determination, a stock option benefit is generally presumed to relate to the period of employment that is required as a condition for the employee to acquire the right to exercise the option (i.e., the "vesting period"). Further, a stock option benefit is generally presumed not to relate to past services, unless there is evidence to indicate that past services are relevant in the particular circumstances.

However, where the terms of the option agreement are such that the grant of the option is treated as a transfer of ownership of the securities (e.g. because the options were in-the-money or not subject to a substantial vesting period), the CRA may attribute the benefit accordingly.

Change in Domestic Position

In contrast to the OECD Commentary, the long-standing view of the CRA on determining the location of services to which a stock option benefit relates was such that the benefit was generally considered to be attributable to services rendered in the year of grant, unless there was compelling evidence to suggest that some other period was more appropriate. (endnote 1)

However, for stock options exercised after 2012, the CRA will apply the principles set out in the OECD Commentary to allocate a stock option benefit for purposes of the Income Tax Act, unless an income tax treaty otherwise specifically applies.

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ENDNOTES

1 For example, see Document 2003-0037271I7, Cross-Border Stock Options, dated February 6, 2004.