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The Canada Revenue Agency recently announced[1] a change in its long-standing administrative policy on determining the location of the services to which a stock option benefit relates.

The taxation of employee stock options granted to employees who work in more than one country during their careers has been a source of difficulty for some time. In particular, if the employee works in one country when the options are granted to her but is working in a different country when the options are exercised, it is quite possible that both countries will assert the right to tax.

Historically, the CRA has presumed that for sourcing purposes, the benefit from an employee stock option relates to employment services provided by the employee in the year in which the option was granted, in the absence of ''compelling evidence'' otherwise.[2] However, because stock options are often awarded with the objective of creating an incentive for the employee to remain with the employer (or a related employer) during the vesting period and to encourage maximum effort in the post-grant period, or as a reward for services rendered during a pre-grant period, there are certainly other plausible bases for allocating the right to tax, and quite often another country may take a different view of the matter. Thus, when the employee changes countries, there is a risk of two (or more) countries claiming the right to tax the stock option benefit and hence double taxation, since different countries may use different sourcing rules to allocate the stock option benefit to different periods.

The OECD guidance on determining which country has the primary right to tax in these circumstances is set out in paragraphs 12 to 12.15 of the commentary to article 15 of the OECD model convention. The principles established there require an examination of all the relevant facts and circumstances and create a presumption that the stock option benefit does not relate to past services in the absence of evidence to the contrary. Instead, in allocating the stock option benefit to each source country based on the number of days during which the employment services from which the stock option is derived are exercised in that country, it is generally presumed that the stock option benefit relates to the period of employment required in order for the employee to acquire the right to exercise the stock options (that is, the vesting period).[3]

The CRA has announced that for stock options exercised after 2012, it will apply these OECD sourcing principles to allocate the stock option benefit, unless an applicable tax treaty provides for a different result.[4] Depending on the facts, this may create an incentive for holders of employee stock options who have worked in Canada during part of the relevant period to exercise their options before the end of 2012 or wait until early in 2013, when doing so would significantly change the Canadian tax result. ◆

♦ *Steve Suarez, Borden Ladner Gervais, Toronto*

[1]The policy change was announced September 25 at the British Columbia Tax Conference (Canadian Tax Foundation).

[2]*See*, for example, CRA document 2003-0037271I7, Feb. 6, 2004.

[3]When the terms of the option agreement are such that the option grant is treated as a transfer of the ownership of the securities (for example, no significant vesting period), the result may be different.

[4]*See* CRA document 2012-0459411C6.