



CANADIANS FOR TAX FAIRNESS
CANADIENS POUR UNE FISCALITÉ ÉQUITABLE



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Mr. Ted Cook, Director General
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Dear Mr. Cook:

Re: **Consultations on Tax Treatment of Stock Options**

We initially welcomed the federal government's announcement that it was planning to eliminate or restrict the stock option tax deduction. The stock option deduction is one of the most egregious of all the federal government's tax loopholes for a number of reasons:

1. It is **highly regressive and increases inequality** with [99% of the value going to the 10% highest income](#) group, and two-thirds going to the 0.01% richest Canadians with annual incomes of over \$1 million. This is one of the major reasons the most affluent CEOs and others are able to pay lower rates of tax than ordinary working Canadians. It's also effectively sexist, with only 23% of the value of this loophole going to women and [77% going to men](#).
2. This tax loophole is also **expensive**, costing the federal government an [estimated \\$710 million in foregone revenues annually](#), and also costing provinces that use the federal income tax base additional hundreds of millions—including [\\$220 million for Ontario alone](#)—with the total cost to federal and provincial governments well-over \$1 billion annually.
3. The loophole is also **economically damaging**. It encourages CEOs and executives to have their corporations engage in share buybacks, which boosts the value of their own compensation, rather than investing in the economy and creating more jobs. It has been well-documented how executive stock compensation [undermines productive investment](#). In fact Roger Martin, former dean of the Rotman School of Management and founder of the Martin Prosperity Initiative, targets stock option compensation as one of the major factors undermining the health of corporations and our economy in his book, [Fixing the Game](#).

However, the government's proposed changes announced in the 2019 Federal Budget with further details published by the Department of Finance, are, unfortunately, profoundly disappointing. They would have the effect of only partially closing this loophole, while opening up many small loopholes that would allow most to continue to take advantage of this tax preference.

The government's proposals would:

- Retain an annual \$200,000 limit on employee stock options at the time of granting that will still allow a tax preference every year for each recipient employee. According to the proposals, these

annual limits could be doubled or tripled up with different employers. The total value of stock options for each employee at the time of vesting could wind up well-above \$200,000 each year.

- Only apply the \$200,000 limit to employees at “large, long-established, mature” firms, while employees at other firms and “start-ups and emerging businesses” could continue to make full use of this tax loophole. It is difficult to understand how the lines between these types of firms will be drawn. The government’s proposals suggest a number of different criteria which will make the rules more complex, unclear, subject to dispute, difficult to enforce and ultimately ineffective.
- Exempt Canadian-controlled private corporations (CCPCs) that meet “prescribed conditions” from these limits.

All these exceptions to closing the larger loophole would open many smaller loopholes, which would inevitably get roomier as interested parties with influence lobby to further bend the rules and lines.

In fact, Finance Canada didn’t include any recovery of revenues associated with these proposals in the 2019 budget and department officials confirmed they weren’t expecting these changes to recover any of the revenues lost. While these proposals may appear to address the problems of this highly regressive tax loophole, in reality they may achieve little of substance, while even *further* complicating the tax system.

Rather than improving the tax system, these changes are instead contrary to many of the [widely-accepted guiding principles of good tax policy](#) (as articulated by the OECD and CPAs among others) including: equity and fairness, certainty, simplicity, neutrality, effectiveness and minimizing non-compliance.

The federal government has made a good case for “eliminating inefficient tax measures that unfairly benefit the wealthiest Canadians” by pointing out that a mere 2,300 individuals making over \$1 million annually each—the top 0.01% of Canadians—received two thirds of the value of this tax break.

However, it hasn’t made a good case for retaining the stock option deduction in any form, including in the ways that are now proposed. The 2019 Budget, Finance Canada press releases and the backgrounder for these consultations all state that the public policy rationale for employee stock options is to provide “smaller, growing companies, such as start-ups, (that) do not have significant profits and may have challenges with cash flow...(with) a form of compensation that is linked to the future success of the company.”

These and other companies can always continue to use stock options to attract and retain employees with a deferred form of stock compensation that can be expected to rise in value, but there is no compelling reason to provide tax preferences for them. In fact, continuing to provide tax preferences to employees for stock options means that the employer can’t deduct their cost for tax purposes, ultimately reducing the firm’s profitability.

For all these reasons, we strongly urge the federal government not to turn this one highly regressive and ineffective loophole into many smaller loopholes, but to simply eliminate all tax preferences for stock options. This would make the tax system more equitable, simple, and effective—[as this government has said it committed to doing](#). It would also provide the federal and provincial governments with over \$1 billion annually that could be used to support important public services.

We don’t need more show and pretense of progressive action; we need real change, and a fundamentally fairer and simpler tax system.