

This publication is provided as a guide only. It is not intended as a substitute for the *Employer Health Tax Act* and Regulations.

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**Employer's tax liability on stock options**

**Purpose of the bulletin**

This bulletin will assist employers in determining what amounts are subject to Employer Health Tax (EHT).

EHT is payable by employers who pay remuneration:

- to employees who report for work at a permanent establishment (PE) of the employer in Ontario, and/or
- to employees who do not report for work at a PE of the employer but who are paid from or through a PE of the employer in Ontario.

An employee is considered to report for work at a PE of an employer if the employee comes to the PE in person to work. If the employee does not come to a PE in person to work, the employee is considered to report for work at a PE if he or she may reasonably be regarded as attached to the PE. For more information on this topic, please see **Information Bulletin entitled Permanent Establishment**.

**Stock options**

Employee stock options are granted under an agreement to issue securities, whereby a corporation provides its employees (or employees of a non-arm's length corporation) with a right to acquire securities of either of those corporations.

The term securities refers to shares of the capital stock of a corporation or units of a mutual fund trust.

**Definition of remuneration**

Remuneration as defined in subsection 1(1) of the *Employer Health Tax Act* includes all payments, benefits and allowances received, or deemed to be received by an individual that, by reason of sections 5, 6 or 7 of the federal *Income Tax Act* (ITA), are required to be included in the income of an individual, or would be required if the individual were resident in Canada.

Stock option benefits are included in income by reason of section 7 of the federal ITA. Employers are therefore required to pay EHT on stock option benefits.

**Non-arm's length corporations**

If a stock option is issued to an employee by a corporation not dealing at arm's length (within the meaning of section 251 of the federal ITA) with the employer, the value of any benefit received as a result of the stock option is included in remuneration paid by the employer for EHT purposes.

**Employee moved to Ontario PE from non-Ontario PE**

An employer is required to pay EHT on the value of all stock option benefits arising when an employee exercises stock option(s) during a period when his or her remuneration is subject to EHT. This includes stock options that may have been granted while the employee was reporting for work at a non-Ontario PE of the employer.

**Employee moved to non-Ontario PE**

An employer is not required to pay EHT on the value of stock option benefits arising when an employee exercises stock option(s) while reporting for work at a PE of the employer outside Ontario.

**Employee not reporting for work at a PE of the employer**

An employer is required to pay EHT on the value of stock option benefits arising when an employee who exercises stock option(s) does not report for work at a PE of the employer but is paid from or through a PE of the employer in Ontario.

**Former employees**

An employer is required to pay EHT on the value of stock option benefits of a former employee if the former employee's remuneration was subject to EHT on the date the individual ceased to be an employee.

## When stock option benefits become taxable

**General rule**

An employee who exercises a stock option to acquire securities is required to include in employment income a benefit determined under section 7 of the federal ITA.

**Canadian-controlled private corporations (CCPCs)**

If the employer is a CCPC within the meaning of subsection 248(1) of the federal ITA, the employee is considered to have received a taxable benefit under section 7 of the federal ITA at the time the employee disposes of the shares.

Employers are required to pay EHT at the time the employee (or former employee) disposes of the shares.

Where employee stock options are issued by a CCPC, but are exercised by the employee after the company has ceased to be a CCPC, the value of the benefit will be included in remuneration for EHT purposes at the time the employee disposes of the securities.

**Non-Canadian-controlled private corporations (Non-CCPCs)**

Any taxable benefit resulting from an employee exercising stock options on securities that are not of a CCPC, including publicly-listed securities or securities from a foreign-controlled corporation, must be included in employment income at the time the options are exercised. EHT is payable in the year that the employee exercises the stock options.

**Federal deferral of taxation does not apply to EHT**

For federal income tax purposes only, an employee can defer taxation of some or all of the benefit arising from exercising stock options to acquire publicly-listed securities until the time the employee disposes of the securities.

The federal deferral of taxation on stock option benefits is not applicable for EHT purposes. Employers are required to pay EHT on stock option benefits in the year that the employee exercises the stock options.

### Employers undertaking scientific research and experimental development

**Exemption**

For a limited time, employers who directly undertake scientific research and experimental development and meet the eligibility criteria are exempt from paying EHT on stock option benefits received by their employees.

For CCPCs, the exemption is available on employee stock options granted before May 18, 2004, provided that the subject shares are disposed of or exchanged by the employee after May 2, 2000, and on or before December 31, 2009.

For non-CCPCs, the exemption is available on employee stock options granted before May 18, 2004, provided that the options are exercised after May 2, 2000, and on or before December 31, 2009.

All stock option benefits arising from employee stock options granted after May 17, 2004, are subject to EHT.

**Eligibility criteria**

To be eligible for this exemption for a year, the employer must meet all of the following eligibility criteria in the taxation year of the employer preceding the taxation year that ends in the year:

- the employer must carry on business through a PE in Ontario in the preceding taxation year (see page 4 Start-ups for the exception)
- the employer must directly undertake scientific research and experimental development (within the meaning of subsection 248(1) of the federal ITA) at a PE in Ontario in the preceding taxation year
- the employer's eligible expenditures for the preceding taxation year must not be less than \$25 million or 10 per cent of the employer's total expenses (see page 4 Eligible expenditures) for that taxation year, whichever is less
- the employer's specified eligible expenditures for the preceding taxation year must not be less than \$25 million or 10 per cent of the employer's adjusted total revenue (see page 4 Specified eligible expenditures) for that taxation year, whichever is less.

For example, if the employer meets all of the eligibility criteria in its taxation year ending June 30, 2001, it is eligible to claim the EHT exemption for the 2002 year.

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**Start-ups**

Start-up companies that do not have a preceding taxation year can apply qualifying tests to their first taxation year. The scientific research and experimental development performed in their first taxation year will determine their eligibility for the first and second years on which EHT is payable.

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**Amalgamations**

In the first taxation year ending after an amalgamation, the employer can apply the qualifying tests to the taxation year of each of the predecessor corporations that ended immediately before the amalgamation.

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**Eligible expenditures**

Eligible expenditures are those incurred by the employer in directly undertaking scientific research and experimental development that qualify for the research & development (R&D) super allowance under the *Corporations Tax Act* (Ontario).

Contract payments received by the employer for performing R&D for another entity are included as eligible expenditures. Contract payments made by the employer to another entity for R&D performed by the other entity are not included as eligible expenditures of the employer.

Specifically, eligible expenditures of the employer for a taxation year are calculated as  $(A+B-C)$ , where:

- A. is the total of the expenditures incurred in the taxation year at a PE in Ontario, each of which would be a qualified expenditure under subsection 12(1) of the *Corporations Tax Act* (Ontario) and is either an amount described in subparagraph 37(1)(a)(i) or 37(1)(b) (i) of the federal ITA or a prescribed proxy amount (as referred to in paragraph (b) of the definition of 'qualified expenditure' in subsection 127(9) of the federal ITA) for the taxation year
- B. is the reduction in 'A' as required under subsections 127(18) to (20) of the federal ITA in respect of a contract payment, and
- C. is the amount paid or payable by the employer in the taxation year that is included in 'A' and that would be a contract payment as defined in subsection 127(9) of the federal ITA made to the recipient of the amount.

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**Specified eligible expenditures**

Specified eligible expenditures of the employer for a taxation year include:

- the employer's eligible expenditures for the taxation year
- the employer's share of eligible expenditures of a partnership in which it is a member during a fiscal period of the partnership that ends in the taxation year, and
- eligible expenditures of each associated corporation that has a PE in Canada for any taxation year that ends in the employer's taxation year, including the associated corporation's share of eligible expenditures of a partnership in which it is a member.

<b>Total expenses</b>	The employer's total expenses are determined in accordance with generally accepted accounting principles (GAAP), excluding extraordinary items. Consolidation and equity methods of accounting are not to be used.
<b>Total revenue</b>	An employer's total revenue is the gross revenue determined in accordance with GAAP (not using the consolidation and equity methods of accounting), less any gross revenue from transactions with associated corporations having a PE in Canada or partnerships in which the employer or the associated corporation is a member.
<b>Adjusted total</b>	The employer's adjusted total revenue for a taxation year is the total of the following amounts: <ul style="list-style-type: none"> <li>total revenue of the employer for the taxation year</li> <li>the employer's share of total revenue of a partnership in which it is a member during a fiscal period of the partnership that ends in the taxation year</li> <li>total revenue of each associated corporation that has a PE in Canada for any taxation year that ends in the employer's taxation year, including the associated corporation's.</li> </ul>
<b>Short or multiple taxation years</b>	Eligible expenditures, total expenses, and total revenue are extrapolated to full-year amounts where there are short or multiple taxation years in a calendar year.
<b>Partnerships</b>	If a partner is a specified member of a partnership (within the meaning of subsection 248(1) of the federal ITA), the share of eligible expenditures, total expenses and total revenue of the partnership attributable to the partner is deemed to be nil.

### Summary of EHT on stock options

	R& D intensive		Non-R&D intensive
	Stock options granted before May 18, 2004	Stock options granted after May 17, 2004	
CCPC	Exempt from EHT if the securities are disposed of after May 2, 2000, and on or before December 31, 2009. Otherwise, EHT is payable when securities are disposed of by the employee.	No exemption. Same as non-R&D intensive.  EHT is payable when securities are disposed of by the employee.	EHT is payable when securities are disposed of by the employee.
Non-CCPC public and private corporations	Exempt from EHT if the options are exercised after May 2, 2000 and on or before December 31, 2009. Otherwise, EHT is payable when stock options are exercised.	No exemption. Same as non-R&D intensive.  EHT is payable when stock options are exercised (federal income tax deferral rule does <b>not</b> apply for EHT purposes).	EHT payable when stock options are exercised (federal income tax deferral rule does <b>not</b> apply for EHT purposes).

**Written interpretations**

To obtain a written interpretation on a specific situation not addressed in this publication, please send your request in writing to:

Ministry of Revenue  
Tax Advisory Services Branch  
Income Tax Related Programs Section  
Employer Health Tax  
33 King Street West, 3<sup>rd</sup> Floor  
Oshawa ON L1H 8H5

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**Related publications**

Other publications which provide further details on this topic include:

Remuneration  
Permanent Establishment  
Associated Employers  
Ontario Research Employee Stock Option Credit

**More Information**

To obtain the most current version of this publication, or additional information, visit our website at [ontario.ca/revenue](http://ontario.ca/revenue) and enter 2536 in the find page field at the bottom of the webpage or contact the Ministry of Revenue at:

1 866 ONT-TAXS (1 866 668-8297)  
1 800 263-7776 teletypewriter (TTY)

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