

Taxation of Executive Compensation and Retirement

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PENSIONS

remuneration of office-holders: “fixed or ascertainable”

The term “fixed or ascertainable” is used in the Canada Pension Plan (“CPP”) to determine whether income received from an office is considered pensionable and subject to CPP deductions. In some instances, whether income from an office is fixed or ascertainable is straightforward to determine. However, the litigation in *Real Estate Council of Alberta v. Minister of National Revenue* and *Her Majesty The Queen in Right of Ontario v. Minister of National Revenue* illustrate the potential difficulty in applying the term “fixed or ascertainable” to determine whether the receipt of attendance fees and per diems, respectively, will be recognized as being pensionable. In both cases, the Tax Court of Canada recently found that the income received by the taxpayers was not pensionable and, accordingly, was not subject to CPP deductions. Notwithstanding that these Tax Court of Canada decisions are consistent with one another, and consistent with the prevailing case law, the Minister of National Revenue has appealed both decisions. It is now up to the Federal Court of Appeal to confirm whether certain amounts paid to board members, council members and other office-holders are properly excluded as being pensionable for CPP purposes. **Jordan Fremont** and **Susie Taing** examine the implications of these decisions. 1355

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INCENTIVES AND BENEFITS

stock option plans and cash-out payments

In the ordinary course of administering an employee stock option plan, a cash-out payment made by an employer to employees who surrender their employee stock options has generally been characterized as deductible business expenses. However, in the context of a corporate reorganization or an acquisition, such payments have generally been characterized as non-deductible capital expenditures. The recent *Imperial Tobacco Canada Limited v. The Queen* case is the most recent in a line of cases dealing with the deductibility of cash-out payments made by an employer to employees for the purposes of cashing out employee stock options. In *Imperial Tobacco*, the Tax Court of Canada held that a cash-out payment made to employees, in the context of a going private transaction, was on account of capital. The *Imperial Tobacco* decision highlights the potential for unfavourable tax consequences to employers in certain circumstances. Imperial Tobacco Canada Limited has filed an appeal of the Tax Court of Canada decision. However, in the interim, cash-out payments made in the context of a reorganization or an acquisition remain problematic and employers are likely to be denied a deduction. In contrast, cash-out payments made in the ordinary course of administering an employee stock option plan should continue to be deductible, subject to the employer deciding to forego the deduction in order to permit the employees to claim the deduction under paragraph 110(1)(d) of the Income Tax Act. **Paul Carenza** and **Michael Platt** explore the decision and its impact. 1360

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Taxation of Executive Compensation and Retirement

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This regular feature is edited by Elizabeth H. Boyd of Blake, Cassels & Graydon LLP. It reviews current developments pertaining to pensions and other deferred plans.

REMUNERATION

Remuneration of Office-holders: “Fixed or Ascertainable” – That Is the Question

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Introduction

The term “fixed or ascertainable” is used in the Canada Pension Plan¹ to determine whether income received from an office is considered pensionable earnings and subject to CPP contributions. In some instances, whether income from an office is fixed or ascertainable is straightforward to determine. However, the appeal by the Minister of National Revenue (“MNR”) of two recent Tax Court of Canada (“TCC” or “Tax Court”) decisions, *Real Estate Council of Alberta v. Minister of National Revenue*² and *Her Majesty The Queen in Right of Ontario v. Minister of National Revenue*,³ illustrate the difficulty in applying the term “fixed or ascertainable” to determine whether the receipt of attendance fees and per diems, respectively, qualify as pensionable employment. In both decisions, the Tax Court found that the income received by the taxpayers was not pensionable employment and accordingly, was not subject to CPP contributions.

¹ R.S.C. 1985, c. C-8 [“CPP”].

² 2011 TCC 5 [“RECA”].

While the *RECA* and *HMQ* decisions were decided consistently with one another, and consistent with the prevailing case law, the MNR has appealed both decisions. We therefore look to the Federal Court of Appeal to confirm whether certain amounts paid to board members, council members and other office-holders are properly excluded as pensionable earnings for CPP purposes.

Statutory Framework

In both the *RECA* and *HMQ* cases, the only issue before the TCC was whether the remuneration paid to the taxpayers was “fixed or ascertainable.” Where a taxpayer is an office-holder, and not an employee, remuneration will only be considered pensionable if it is “fixed or ascertainable.” Only pensionable employment is subject to CPP contributions. The statutory framework for this analysis begins with subparagraph 6(1)(a) of the CPP. Subparagraph 6(1)(a) sets out what employment is pensionable. It states:

6(1) Pensionable employment is

(a) employment in Canada that is not excepted employment; ...

The term “employment” is defined in subsection 2(1) of the CPP as follows:

“employment” means the performance of services under an express or implied contract of service ... and includes the tenure of an office; ...

Since employment includes “the tenure of an office” for persons who are not employees, it is necessary to look at the CPP definition of “office” to determine whether amounts paid to such persons are pensionable and subject to CPP contributions. Subsection 2(1) of the CPP defines “office” as follows:

“office” means the position of an individual entitling him to a *fixed or ascertainable* stipend or remuneration ... and “officer” means a person holding such an office; [emphasis added]

In other words, for a taxpayer who is an office-holder, amounts paid for services will only be captured by the CPP if the person is in a position that entitles him to a fixed or ascertainable stipend or remuneration.

³ 2011 TCC 23 [“HMQ”].

Judicial Treatment

A handful of cases have dealt with the issue of whether remuneration received by an office-holder is “fixed or ascertainable.” As indicated by the decisions in *E.F. Anthony Merchant v. Her Majesty The Queen*⁴ and *Payette v. Canada (Minister of National Revenue – M.N.R.)*,⁵ the Tax Court has adopted two different tests for determining whether remuneration is “fixed or ascertainable.”

The issue in the 1984 decision of *Merchant* was whether a taxpayer’s remuneration is “fixed or ascertainable” in the context of determining the deductibility of expenses under the Income Tax Act.⁶ The taxpayer was an unsuccessful candidate in an election for leader of the Saskatchewan Liberal Party. As leader, he expected to receive between \$20,000 and \$40,000 per year from the party, but the actual amount of remuneration was dependent on a number of factors out of the taxpayer’s control. From this amount, the taxpayer attempted to deduct his campaign expenses as business expenses.

The Federal Court – Trial Division rejected the argument that the taxpayer’s remuneration was “fixed or ascertainable” and therefore considered income from an “office” as defined in the Income Tax Act. The determination of whether the taxpayer’s remuneration was “fixed or ascertainable” was not central to the outcome in *Merchant*, however, on the point of income being “ascertainable” the Court stated the following, in *obiter*:

Indeed, I think such income is ascertainable. I take that word to mean that the amount to be paid is capable of being made certain, or *capable of being determined but not that a definite sum be known by the office holder at the commencement of holding office*. The word has to have some meaning beyond “fixed” or else it is completely redundant.⁷ [emphasis added]

and:

I am not convinced that at the time of taking office the taxpayer must know how much he will receive. It seems to me a per diem rate,

*or a specified amount per sitting renders the income sufficiently ascertainable to meet the definition in section 248(1) [of the Income Tax Act].*⁸ [emphasis added]

The above *obiter* comments have been referred to in subsequent decisions of the Tax Court for the proposition that “fixed or ascertainable” does not require a taxpayer to know the precise amount that he or she will receive as a stipend or remuneration in a year from an office. Based on the reasoning in *Merchant*, remuneration would be considered “fixed or ascertainable” if some, but not all, of the information required to calculate the total remuneration received by the end of a tax year is available to the taxpayer upfront.

The reasoning in *Merchant* can be difficult to apply in the context of *Employment Insurance Act*⁹ deductions (“EI deductions”) and CPP contributions since an employer deducts and remits these amounts to the Canada Revenue Agency on the basis of total remuneration received by a taxpayer in a year. Furthermore, *Merchant* was decided on the basis of whether the taxpayer’s income was considered business income or income from an office or employment under the Income Tax Act. Concluding that the income received was business income, the Court’s comments in relation to whether the income was “fixed or ascertainable” and thus income from an office, is therefore *obiter*.

Subsequent to *Merchant*, a new line of cases emerged interpreting the term “fixed or ascertainable” in the context of EI deductions and CPP contributions. The 2002 decision of the Tax Court in *Payette* is one such decision. *Payette* is often referred to by the TCC and has been followed by that Court since,¹⁰ including the Tax Court’s decisions in *RECA* and *HMQ*.

In *Payette*, the Tax Court heard an appeal of nine taxpayers from a decision of the MNR that they held insurable employment under the EI Act. In *Payette*, the taxpayers were members of the Review Committee (“Committee”) established by the Commission des services juridiques (“Commission”), a body established

⁴ 84 DTC 6215 [“*Merchant*”].

⁵ [2002] T.C.J. No. 386 [“*Payette*”].

⁶ R.S.C. 1985, c. 1 (5th Supplement), as amended.

⁷ *Merchant*, supra note 4.

⁸ *Ibid.*

⁹ S.C. 1996, c. 23 [“EI Act”].

¹⁰ See *Churchman v. The Queen*, 2004 TCC 191, *Jean Guyard v. The Minister of National Revenue*, 2007 TCC 231 and *Denise Vachon*, 2008 TCC 480.

by Quebec's *Legal Aid Act*. The Committee was comprised of three members, one of which was required to be an advocate, but in practice, all Committee members were advocates. The Committee members were tasked with making and writing decisions on an individual's eligibility for legal aid. The members were not employees of the Commission, but were appointed for terms of one year and were not required to provide their legal services exclusively to the Commission. The members were paid an hourly rate based on the time they spent hearing applications, deliberating and writing their decisions.

In finding that the Committee members did not receive a "fixed or ascertainable stipend or remuneration," the Tax Court first referred to paragraph 6(f) of the *Employment Insurance Regulations*,¹¹ which incorporates by reference the definitions of "employment" and "office" in subsection 2(1) of the CPP. Paragraph 6(f) of the EI Regulations states:

6. Employment in any of the following employments ... is included in insurable employment:

[...]

(f) employment of a person who holds an office, as defined in subsection 2(1) of the Canada Pension Plan.

Therefore, in the analysis of whether the Committee members were engaged in insurable employment under the EI Act, the Tax Court was required to look to the CPP to determine whether the remuneration of these office-holders was "fixed or ascertainable." On this point, the Tax Court stated:

In the present case, it is clear that the position does not entitle a person to a fixed remuneration or stipend ... It is not known how many times each member is called upon to sit on the review committee or how many days or hours are spent on this activity in a given year. The information about the number of review committee sittings held and the number of review applications heard each year does not provide a reliable factor for individual members. The Court has no idea of the "stipend" or the "remuneration" that the members of the review committee were likely to receive for rendering their services; nor has

any such information been adduced, except that the members are paid on a fee basis at a rate of \$50 per hour. The Court considers that *merely indicating the hourly rate set by the Commission des services juridiques is insufficient to establish that the position itself makes a member eligible for a "fixed or ascertainable stipend or remuneration"*.¹² [emphasis added]

From *Payette*, it is clear that the Tax Court requires more information than the following in order to find that an office-holder's remuneration is "fixed or ascertainable:" aggregate data summarizing the number of Committee sittings, the number of review applications heard each year by the Committee and the hourly rate paid to each Committee member. This is an indication that historical information about the potential or median amount of an office-holder's remuneration in a year is insufficient for meeting the definition of "fixed or ascertainable." A logical extension of this reasoning is that in order for remuneration to be considered "fixed or ascertainable," the amount to be paid to an office-holder must be known in advance.

The reasoning in *Payette* has emerged as the prevailing view of the Tax Court. Both *RECA* and *HMQ* were decided on this basis.

Tax Court Decisions in RECA and HMQ

The Tax Court issued its decisions in *RECA* and *HMQ* on January 5, 2011 and January 17, 2011, respectively. The facts in both cases bear resemblance to the facts in *Payette*, and on this basis alone it is understandable why the Tax Court was inclined to follow *Payette* and not *Merchant*. While the Tax Court walked through the statutory analysis – that amounts paid for services to a taxpayer who is an office-holder, and not an employee, will only be captured by the CPP if the person is in a position that entitles him to a fixed or ascertainable stipend or remuneration – the analysis turned on the interpretation of the term "fixed or ascertainable."

At issue in the *RECA* case was the treatment of meeting attendance fees paid to Beverly Andre-Kopp, a member of the Real Estate Council of Alberta ("Council"). The Council is the regulatory body for the Alberta real estate industry, responsible for setting and

¹¹ SOR/96-332 ["EI Regulations"].

¹² *Payette*, supra note 5 at paragraph 26.

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enforcing standards of conduct and administering the Alberta *Real Estate Act* with a view to promoting the integrity of the real estate industry. The fees in question were paid to Andre-Kopp in accordance with the Council's meeting fee schedule, which provides for fees to be paid based on attendance at Council meetings, committee meetings, hearings and performing other functions in carrying out the objectives of the Council. No CPP contributions were deducted from the meeting fees paid to Andre-Kopp.

The TCC determined that since the number of meetings in a year and the duration of the meetings could not be known in advance, despite knowing the fees that Andre-Kopp would receive for attending each Council and committee meeting, there was insufficient information to allow for the advance calculation of remuneration that would be earned from meeting fees in a year. The TCC stated:

Turning to the facts in the within appeal, a review of the honorarium schedule – Exhibit A-1 – discloses that during the years in question there was *little information that would permit a member of RECA to know in advance the amount of his or her remuneration*. The number of hearings would need to be known as well as their duration.¹³ [emphasis added]

Following its own decision in *Payette*, the TCC held that the meeting fees paid to Andre-Kopp were not fixed or ascertainable, and that Andre-Kopp was not engaged under a tenure of office within the meaning of section 2 of the CPP. Consequently, the TCC ruled that meeting attendance fees were not pensionable or subject to CPP contributions.

The *HMQ* case dealt with amounts paid to Roger Davidson and Gail Stiffler, members of Ontario's Judicial Appointments Advisory Committee ("JAAC"). The JAAC is responsible for making judicial appointment recommendations to the Attorney General of Ontario. As JAAC members, Davidson and Stiffler were each entitled to per diems when they were required to review applications from candidates, conduct reference checks on certain candidates, interview candidates and meet with the other committee members to discuss their recommendations for judicial

appointments. As in *RECA*, CPP contributions were not deducted from the per diems paid to Davidson and Stiffler.

The TCC determined that the total amount of *per diems* to be paid to JAAC members could not reasonably be known in advance, and that, accordingly, the per diems were not fixed or ascertainable and therefore, the remuneration was not pensionable or subject to CPP contributions. The Court explained its reasons, in part, as follows:

For the purposes of subsection 2(1) of the *Plan*, the stipend or remuneration must be ascertainable; they must be known to both the payer and payee or be calculable to a reasonable degree of certainty *before the term of office begins*. Remuneration is ascertainable for example if a person knows or reasonably expects that he or she will be called upon to attend approximately 20 meetings of a committee during the year and will receive payment of \$100 for each meeting. The person would know with a reasonable degree of certainty that the remuneration from the office will be approximately \$2,000 for the year. If at the commencement of the year or beginning of the tenure of the position, the person has no idea how many meetings he or she will attend in a year, there is no way to reasonably ascertain the stipend or remuneration.¹⁴ [emphasis added]

The Tax Court's decisions in *RECA* and *HMQ* are the logical extension of the conclusions reached in *Payette*. In *Payette*, the Tax Court reasoned that knowing one piece of the equation in determining an office-holder's remuneration for a tax year is insufficient for it to be considered "fixed or ascertainable," that is, knowing a taxpayer's hourly rate of pay without knowing the number of hours to be worked that year, cannot be considered "fixed or ascertainable" remuneration and should not be subject to CPP contributions. In *RECA* and *HMQ*, the Tax Court clarified that the amounts received must be known "in advance" or "before the term of office begins," extending the reasoning given in *Payette* that knowledge of aggregate historical data on the number of annual Committee sittings and hourly rates were insufficient for concluding that a taxpayer's remuneration was "fixed or ascertainable."

¹³ *RECA*, supra note 2 at paragraph 42.

¹⁴ *HMQ*, supra note 3 at paragraph 25.

Implications

On the TCC's reasoning in the *RECA* and *HMQ* cases, and consistent with the prevailing view before the Tax Court, office-holders whose earnings are not fixed and not reasonably ascertainable in advance (i.e., because they are based on attendance at meetings or for providing services that

cannot reasonably be known in advance) will not be considered engaged in pensionable employment and no CPP deductions should be made from their remuneration. However, the MNR has filed appeals in both the *RECA* and *HMQ* decisions and so the treatment of such earnings for CPP purposes is not yet settled.

Incentives and Benefits

This regular feature is edited by Dov B. Begun, of Osler, Hoskin & Harcourt LLP. It examines major trends and tax planning issues pertaining to executive incentive and benefit plans and arrangements.

STOCK OPTION PLANS

Imperial Tobacco: Stock Option Plans and Cash-out Payments

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The recent *Imperial Tobacco* case¹ is the most recent in a line of cases dealing with the deductibility of payments made by an employer to employees for the purposes of cashing out employee stock options. The decision highlights the potential for unfavourable tax consequences to the employer in certain circumstances.

In *Imperial Tobacco*, in the context of a going private transaction, the employer made a cash-out payment to employees holding options to acquire shares. At the time of the payment, Imperial, the successor to Imasco Ltd., was a public corporation, 42.5% of the shares of which were held by British American Tobacco (“BAT”). BAT wanted to acquire the balance of the Imasco shares. As part of BAT’s strategy, it was desirable to ensure that, following the transaction, there would be no outstanding options to acquire shares of Imasco. Accordingly, the outstanding options under the Imasco stock option plan had to be settled.

Imasco’s stock option plan had been in place since 1983. The plan provided for

employees to acquire shares of Imasco upon paying the applicable exercise price. The plan did not contemplate the surrendering of options in exchange for a cash payment. In the context of the going private transaction, Imasco amended the plan to permit holders of options to elect to surrender their options for a cash payment equal to the amount of the excess of the fair market value of the underlying Imasco shares over the exercise price specified in the option (the “in the money amount”). Further, Imasco agreed to accelerate the vesting of unvested options (conditional on the closing of the going private transaction) to permit such options to be exercised or surrendered and to generally encourage holders of options to exercise their option rights prior to the completion of the transaction. As a result, holders of approximately 70,000 options chose to exercise their options and acquire shares (which were presumably tendered on the acquisition by BAT) while holders of approximately 4.8 million options chose to surrender their options for a cash payment. The cash-out payments totaled \$118 million, which Imasco claimed as a deduction in computing income pursuant to subsection 9(1) of the Income Tax Act² on the basis that the payments were made to satisfy liabilities that had arisen as part of Imasco’s employee compensation arrangements. The Minister of National Revenue disallowed the deduction on the basis that the payments were non-deductible capital outlays, prompting Imasco to appeal to the Tax Court of Canada.

The Court dismissed Imasco’s appeal. In the Court’s view, the answer to the question whether an outlay is to be considered capital or current in nature depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. In the Court’s view, although compensation was the reason for implementing the stock option plan, the cash-out payment arose in the context of reshaping Imasco’s capital structure and, therefore, was on capital account.

¹ *Imperial Tobacco Canada Limited v. The Queen*, 2011 DTC 1037 (T.C.C.).

² R.S.C. 1985, c. 1 (5th Supplement), as amended, hereinafter referred to as the “Act.” Unless otherwise stated, statutory references in this article are to the Act.

In holding against the taxpayer, the Court relied on, and felt bound by, the decision of the Federal Court of Appeal in *Kaiser Petroleum*,³ in which the Court held that a payment made by the taxpayer to extinguish rights under an employee stock option plan was a payment on capital account. In that case, the target in an acquisition had a stock option plan under which employees held options to purchase 126,370 shares, of which 108,650 had vested. The acquisition agreement required that the target offer the holders of vested and unvested options the opportunity to surrender their options for a payment equal to the “in the money” amount of the options. The offer was made, resulting in surrender payments of approximately \$2.7 million, which the target deducted in computing income. In holding against the taxpayer, the Court sought to answer the question whether the surrender payments were expended on the structure within which the profits of the business were to be earned or whether they were part of the money-earning process.

The respondent, in buying out rights under the plan, parted with an asset (the purchase price) and effected a sterilization of future issues of shares. The disbursement made was a once and for all payment which had a direct effect on the capital structure of the corporation. In fact, the Stock Option Plan was later cancelled. Although the plan originated as a form of compensation and immediate compensation was one reason for its termination ... it does not follow that the payment, from the point of view of the respondent, had the character of an operating expenditure. What is important is not the purpose pursued by the respondent but what it did and how it did it.⁴

The decision in *Kaiser Petroleum* was preceded by the *Canada Forgings* case.⁵ In that case, in the context of an acquisition of the shares of Canada Forgings, two employees of the target agreed to dispose of and relinquish all their rights to purchase shares under stock option agreements in consideration for a payment equal to the in the money amount of the options. Canada Forgings paid \$325,000 to each employee and deducted these payments

as a current business expense. The Minister disallowed the deduction and Canada Forgings appealed. In dismissing the appeal, the Federal Court concluded that the payments were of a capital nature and could not be deducted as a business expense.

The payment is non-recurring and was made at the time that Toromont was attempting to acquire all shares of the plaintiff company with the full cooperation of the latter’s officers. Such a large payment also indicates an item of capital structure.

In *British Insulated and Helsby Cables Limited v. Atherton*, 1926 A.C. pp. 213-214, it is stated:

When an expenditure is made, not only once and for all, but with a view of bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such expenditure as properly attributable not to revenue but to capital.⁶

Notwithstanding the above decisions, a different conclusion was reached in the *Shoppers Drug Mart* case.⁷ That case involved the same going-private transaction that was at issue in the *Imperial Tobacco* decision. Shoppers Drug Mart (“SDM”) was a subsidiary of Imasco and employees of SDM held options to acquire Imasco shares. Following the surrender of the options to Imasco, and the payment by Imasco to the option holders of approximately \$54 million, SDM reimbursed Imasco for such payments. SDM claimed a deduction in computing income on the basis that the reimbursement represented a compensation expense for its employees that had been paid by its parent company. The Minister of National Revenue disallowed the deduction and SDM appealed. In holding in favour of SDM, the Tax Court of Canada distinguished *Kaiser Petroleum* on the basis that the payment was not made to reshape the capital structure of SDM.

I start from the premise that in the ordinary course, a payment made by an employer to an

³ *The Queen v. Kaiser Petroleum Limited*, 90 DTC 6603 (F.C.A.).

⁴ *Ibid.* at 6606.

⁵ *Canada Forgings Ltd. v. The Queen*, 83 DTC 5110 (F.C.T.D.).

⁶ *Ibid.* at 5113.

⁷ *Imperial Tobacco Canada Limited (successor by amalgamation to Shoppers Drug Mart Limited) v. The Queen*, 2008 DTC 2043 (T.C.C.).

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employee for the surrender of his or her option under a stock option plan to acquire shares of the company is a deductible expense to the company. This conclusion is not based on any specific provision of the Income Tax Act. It is simply part of employee compensation and is therefore a cost of doing business under section 9. [It is true that section 7 of the Income Tax Act provides a code with respect to the tax treatment of employees with respect to employee stock options and that treatment differs from that according to stock options under *Abbott v. Philbin*, [1961] A.C. 352. Section 7 does not however deal with the tax treatment of the employer where a payment is made to surrender the option. It was not argued (correctly, in my view) that paragraph 7(3)(b) dealt with the SDM situation or that *The Queen v. Placer Dome Inc.*, 92 DTC 6402 had any application.]

Why then does a payment to employees who are option holders become a capital expense just because it is made in the course of a corporate reorganization of the parent company? The short answer is that it does not. The business of SDM continued throughout the reorganization of the Imasco corporate structure. SDM, as a separate corporate entity, was not being reorganized. It had payrolls to meet and expenses to pay. It may possibly be that the reason for accelerating the vesting of the stock options was to enable as many employees as possible either to exercise their options or surrender them so that BAT could achieve its goal of obtaining all outstanding shares of Imasco. This does not turn the payment of what is patently a revenue expense into a capital expense.

Here, the rearrangement of the Imasco corporate structure did not impinge in any way on the corporate structure of SDM. Desjardins, J.A. appears to have felt that the cancellation of the stock option plan of the appellant, Kaiser Petroleum Ltd., was an advantage for the lasting benefit of the appellant. I do not see how a payment by SDM to Imasco to reimburse it for payments made to employees of SDM created or achieved anything of lasting benefit to SDM. The business of SDM went on as usual.⁸

In light of the result in *Kaiser Petroleum* and more recently *Imperial Tobacco*, the *Shoppers Drug Mart* decision provides a narrow distinction due to the fact it was the parent company's capital structure that was being reorganized. However, it is interesting to note the Court's starting premise in the *Shoppers Drug Mart* decision was that a cash-out payment is patently deductible to the employer as part of its ordinary compensation expense. It is arguable that this should be the end of the inquiry. Why should a cash-out payment lose its character in the context of an acquisition transaction? Why treat the cash-out payment differently than a payment of deferred bonuses prior to an acquisition? Perhaps the different treatment results from a desire to equate a target's cash-out payment with the cost to the acquiror of optioned shares purchased on an acquisition. If all of a target's options are exercised and the underlying shares sold to the acquiror, the acquiror must pay a greater amount to acquire all the outstanding shares of the target, with such an expenditure clearly being on capital account. The acquiror would also thereby acquire a target with greater cash reserves, undepleted by any cash-out payment. In contrast, with a cash-out payment, the acquiror pays a lesser amount to acquire all the outstanding shares of the target. If the target is entitled to a deduction in respect of the cash-out payment, there is the appearance that a capital expenditure (the cost of acquiring the target's optioned shares) is "transformed" into a deductible expense.

Based on the foregoing decisions, it appears that in most instances where a stock option cash-out payment is made in the context of an acquisition of the grantor of stock options, deductibility will be an issue. Based on the *Imperial Tobacco* decision, it will likely be irrelevant whether:

- the cash-out payment is required by the acquisition agreement or merely encouraged;
- the stock option plan is formally cancelled following the cash-out payments;
- employee retention plays a role in the cash-out payments;
- the obligation to make the cash-out payment arises under the stock option plan or the acquisition agreement; or

⁸ Ibid. at 2047-2049.

- the cash-out right is contingent on the acquisition transaction or more generally available to option holders.

The *Imperial Tobacco* decision has been appealed. It will be interesting to see whether the Federal Court of Appeal follows its prior decision in *Kaiser Petroleum* or whether the Court will find a basis on which to permit a deduction. In the interim, cash-out payments

in the context of an acquisition remain problematic and employers are likely to be denied a deduction. In contrast, cash-out payments made in the ordinary course of administering a stock option plan should continue to be deductible, although there is now the additional issue of whether the employer would elect to forego the deduction in order to permit the option holder to claim the deduction under paragraph 110(1)(d) of the Act.

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