CIBC PRIVATE WEALTH

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CONSIDER USING EMPLOYEE STOCK OPTIONS FOR CHARITABLE GIFTING

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Kate helps clients consider their social legacy, whether that means giving to charities and non-profits, volunteering or making socially responsible investments.

Kate is a lawyer called to the Bar in Ontario and is a certified financial planner (CFP). Prior to joining CIBC, she spent 15 years practicing charity and non-profit law at a national law firm. Kate has been recognized for her expertise by the Canadian Legal Lexpert Directory and Best Lawyers in Canada. She is an executive member of the Charity and Not-for-Profit Section of the Canadian Bar Association.

Kate is a frequent writer and speaker on charity and non-profit issues.

Executive Summary

Gifting publicly-listed securities from an exercise of stock options to charity can be a tax-efficient way to give more to your favourite cause. If you work for a publicly-traded company and you get stock options, then you may want to consider using them to make a gift to charity. Why? With a little planning, gifting these securities can eliminate the taxable employment benefit that normally arises when exercising employee stock options. In this piece, we take a look at this tax-efficient way to support the causes that matter to you while maximizing the value of your gift.

Taxation of stock donated upon option exercise

In general, when an employee stock option is exercised the difference between the exercise price and the fair market value of the securities is included in income as an employment benefit.[1] For qualifying options[2], you can claim an offsetting deduction equal to one-half of the benefit, so that only 50%[3] of the stock option benefit is taxed at your marginal rate.[4]

With a little planning, you can eliminate taxes on your stock options while helping a cause that matters to you.

When you donate stock received upon exercising employee stock options to a registered charity—including your private foundation or donor advised fund—you'll get a charitable tax receipt for your gift's fair market value. You can use this to claim a charitable donation credit. Also, you may be able to claim a tax deduction equal to another one-half of the taxable benefit of exercising the option. This means that the entire employee stock option benefit is effectively tax-free.

How to donate using options

To claim this additional tax deduction, you need to make the gift in one of the two ways listed below:

1. Exercise the options, receive the securities and donate them to a registered charity within 30 days of the exercise and in the same calendar year. Be careful if you're exercising the securities near year end as this will shorten the time to donate them to charity.
2. Alternatively, you can direct the broker to exercise your securities, sell them and pay the proceeds directly to the charity. Most brokers will have a written form for this direction. Note that it's important you don't receive the proceeds in your own account—this method only works if the proceeds are paid directly to the charity from the broker.

No capital gains tax

You can also eliminate any capital gains tax when you gift the publicly-listed securities. If you exercise the options and the securities' value increases during the 30-day window, any capital gain accrued between the date the securities were acquired and the date they were donated to charity, is eligible for the full exemption from capital gains tax.

Other requirements

Here are some of the other requirements to be able to claim the tax deductions related to the exercise of the stock options and the donation of the securities to charity:

1. You're an employee
2. You're arm's length from your employer
3. The options are for publicly-listed securities
4. The securities have characteristics like common shares
5. The exercise price for the options is at least the fair market value at the time the options were granted
6. The options were either:
   a. Issued before July 1, 2021
   b. Issued by an employer whose annual gross revenue does not exceed $500 million, or
   c. For each appliable vesting year, for securities with a fair market value of $200,000 or less as of the date of grant[5]

We recommend you have your tax professional confirm if you can claim the tax deduction.

[1] For employee stock options granted by Canadian-controlled private corporations (CCPCs), the income inclusion is generally deferred until the securities are sold.
[2] To qualify for this deduction, among other requirements, the option price can't be less than the fair market value of the securities at the time the option was granted.
[3] For Quebec taxation, this deduction is reduced to 25% for some employee stock options.
[4] For options granted after June 30, 2021, there may be a limit to the amount of stock options granted annually that qualify for the deduction.
[5] For employers with annual gross revenues exceeding $500 million, you can gift securities from each vesting year with a greater value, but only the securities worth $200,000 as of the date of grant from each vesting year are eligible for these deductions.

Withholding tax

When you exercise options, your employer (via your broker) is required to withhold tax on the exercise. Withholding tax is not required, however, on the portion of the taxable benefit reduced by a deduction. It is also not required when you exercise your options, and direct your broker to sell the securities and gift all the proceeds to charity. To get the full deduction you need to request that the broker not withhold tax and gift 100% of the proceeds to charity. Please confirm with your payroll administrator whether they will continue to withhold on a portion of the taxable benefit when securities are donated in-kind to the charity.

Cashless exercise

When you exercise options, generally you need to pay the exercise price for the options. But if instead, you direct your broker to deduct the exercise price from the proceeds of selling the securities (known as a "cashless exercise"), then the charity won't receive the full proceeds. In this case, you'll end up paying tax on the portion of the proceeds not given to charity.

Example

Florence has an option to purchase 1,000 securities of ABC Corp. at $4 and the securities are now worth $10. She doesn't want to pay the $4,000 to exercise the option and purchase the securities, so she instructs her broker to exercise the options and pay the proceeds to charity. In this case, the charity receives $6,000, which is the proceeds of $10,000 less the exercise price of $4,000.

Since Florence is only sending a portion of the proceeds to charity, her tax deduction will be prorated for her $6,000 gift.[6] If Florence wants to fully eliminate the tax on the exercise, she will need to pay the exercise price of $4,000 herself, and gift the full $10,000 to charity. Florence may want to speak with her CIBC advisors to determine if any additional planning opportunities are available to fund the exercise costs.

Owning more of the same securities

You may already own the same securities ("identical properties") as in your stock option agreement. In this case, you'll need to designate the optioned securities as the securities gifted in your income tax return for the year of disposition. To make this designation, there can be no other acquisition or dispositions of the same securities from the date of the exercise until the date the securities are gifted.

Designating the optioned securities makes sure you have gifted the right securities in the 30-day window and it sets the cost base of the gift at the cost base for the exercised options. Without this designation, the cost base would be the weighted average of all the securities you hold, which is required under the averaging rule for identical properties.

What's your option?

With a little planning, you can eliminate taxes on your stock options while helping a cause that matters to you. Contact your tax professional to ensure this strategy is right for your financial situation.

[6] In the example she can claim 60% of the 50% tax deduction. Since she can claim the other 50% tax deduction for employee stock options, she will only be taxable on 20% of the taxable benefit.

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