

Donating the shares or cash proceeds acquired through employee stock options

The benefit realized upon exercising employee stock options is taxable as employment income and not a capital gain. However, subject to certain conditions, you can reduce or eliminate this employment income benefit if you donate the shares or the proceeds acquired through the exercise of employee stock options. This tax deduction is in addition to the benefit of the charitable tax credit available to an individual who donates their option shares, which is based on the value of the shares at the time of the donation. To be eligible for this incentive, the option shares must be publicly-traded securities and the shares (or proceeds acquired through exercising the options) must be donated to a qualifying charity.

Donating stock option shares

If the stock option benefit is also eligible for the 50% (or 1/3) deduction^{1,2} on the qualified exercise of employee stock options, you may be eligible to claim an additional deduction if you donate the stock option shares in the same year you exercise the options, and within 30 days of the options' exercise.³ However, tax changes applicable to stock options issued after June 30, 2021 impose an annual vesting limit on certain stock option grants which may restrict the availability of this deduction. Where the 50% (or 1/3) deduction cannot be claimed because of these revised rules, the additional deduction on the donation of stock option shares or the cash proceeds from stock option shares will also not be available. Please refer to our publication, *Taxation of Employee Stock Options* for more information on the rules applicable to stock options issued after June 30, 2021.

The amount of the additional deduction is equal to 50% (or 2/3) of the lesser of:

- i. the stock option income inclusion as otherwise calculated; and
- ii. the stock option income inclusion based on the Fair Market Value ("FMV") of the shares at the time of the donation.

Accordingly, if the FMV of the shares decreases between the exercise of the option and the donation of the option shares (maximum 30 days), the additional deduction will be proportionately reduced. If the FMV of the shares remains constant or increases between the exercise and the donation of the option shares, the additional deduction will fully eliminate the remaining stock option benefit. Further, any capital gain that has accrued since the shares were acquired under the stock option agreement will continue to be eligible for the full exemption from capital gains tax, subject to existing rules.

Example 1: Donation of option shares⁴

- A Canadian-resident individual makes an immediate donation of 1,000 shares acquired through the exercise of employee stock options.
- Exercise price of each stock option is \$50, and the value of each share (at the time of exercise and donation) is \$100.

In this example, the individual would first have to pay out of pocket the cost of exercising the stock options in order to acquire the shares that are then donated.

Donation of Option Shares		
FMV of shares at exercise		\$100,000
Exercise price (cash outlay)	(A)	(\$50,000)
Stock option benefit		\$50,000
Stock option deduction ⁵		(\$25,000)
Additional deduction (from donation) ⁶		(\$25,000)
Net taxable amount		\$0
Personal tax at 50% rate	(B)	\$0
Donation amount		\$100,000
Donation tax credit at assumed 50% rate (savings)	(C)	\$50,000
Cash flow		
Exercise price (cash outlay)	(A)	(\$50,000)
Tax cost on exercise ⁷	(B)	\$0
Tax savings from donation	(C)	\$50,000
Net cash flow		\$0
Amount of donation		\$100,000

Donating cash proceeds from stock option shares (“Cashless Exercise”)

In a “cashless exercise,” the employee acquires the option shares but then sells them immediately. In this case, the aforementioned 50% deduction^{1,2} is also available, subject to the restrictions applicable to stock options issued after June 30, 2021. Provided the 50% (or 1/3) deduction is available, an additional deduction may apply if the employee directs their financial professional to immediately dispose of the securities acquired from the employee stock options and deliver the proceeds to a qualifying charity.³ The amount of the deduction is calculated based on the following formula:

A x B/C, where:

A is the deduction that would be available if the option shares were donated (as described in the previous section)

B is the cash amount donated to the qualifying charity directly by the individual’s financial professional, and

C is the total sale proceeds from the option shares

In a “cashless exercise,” since a portion of the sale proceeds is generally used to satisfy the option exercise price, the cash amount donated to charity (item B) will often be less than the total sale proceeds from the option shares (item C). As a result, the amount of the additional deduction would be lower compared to a donation of all of the actual option shares.

Example 2: Donation of cashless exercise proceeds⁴

- A Canadian-resident individual makes a donation of the net cash proceeds through a “cashless exercise” of the same options in the previous example.
- In this example, the individual would not have to pay out of pocket to acquire the option shares, since it is funded by a portion of the proceeds from the sale of the option shares. As a result, the donation amount is lower.

Donation of Cashless Exercise Proceeds		
FMV of shares at exercise		\$100,000
Exercise price (funded by proceeds)		(\$50,000)
Stock option benefit		\$50,000
Stock option deduction ⁵		(\$25,000)
Additional deduction (from donation: \$25,000 x \$50,000/\$100,000) ⁸		(\$12,500)
Net taxable amount		\$12,500
Personal tax at 50% rate	(A)	\$6,250
Donation amount		\$50,000
Donation tax credit at assumed 50% rate (savings)	(B)	\$25,000
Cash flow		
Exercise price (funded by proceeds)		\$0
Tax cost on exercise ⁷	(A)	(\$6,250)
Tax savings from donation	(B)	\$25,000
Net cash flow		\$18,750
Amount of donation		\$50,000

Seek advice

The tax rules for employee stock options and the related rules to determine the charitable donation credits are complex. Please consult with your tax advisor to determine the specific tax impact, appropriateness and proper implementation of this strategy in your particular situation, especially in light of recent important changes to the tax rules governing stock option benefits.



For more information, please speak with your BMO Private Wealth professional.



¹ Effective June 25, 2024, the capital gains inclusion rate increased from one-half to two-thirds on the portion of capital gains realized annually in excess of \$250,000 by individuals. In other words, individuals will be allowed an annual \$250,000 threshold below which the capital gains inclusion rate will remain at the previous rate (50%). Although stock option benefits are not considered capital gains, similar changes were introduced to increase the inclusion rate to 2/3 on stock option benefits, effective June 25, 2024. However, the annual \$250,000 threshold for capital gains can be combined to reduce the taxation of employee stock option benefits, at the taxpayer's discretion.

² Subject to restrictions applicable to stock options issued after June 30, 2021, in determining the tax implications of acquiring shares pursuant to the exercise of a stock option, a deduction equal to one-half (or possibly 1/3 for option exercises on or after June 25, 2024) of the taxable benefit is potentially available under the current tax legislation, where the following conditions are met:

- The employee deals at arm's length with the issuer/employer corporation;
- The exercise price is not less than the FMV of the shares at the time the stock options were granted; and
- The shares acquired are considered "prescribed shares" (generally these represent "plain vanilla" common shares). For simplicity, the potential stock option deduction has been referred to as a 50% amount throughout this publication, although the deduction for Quebec provincial tax purposes is generally only 25% (except that the employment benefit from stock options issued after March 13, 2008 by certain Quebec small and medium businesses ("SMB") corporations involved in innovative activities — for the calendar year in which the security option is granted — may qualify for a 50% deduction for Quebec provincial tax purposes). In addition, a stock option deduction equal to 50% (rather than 25%) may also be available for Quebec provincial income tax purposes if the benefit is deemed received for an option on listed shares, granted after February 21, 2017, to an employee of a corporation, where the corporation has total salaries and wages subject to the health services fund contribution of \$10 million or more, for the calendar year that includes the time the agreement was reached or the time the shares were acquired. For qualifying stock options exercised on or after June 25, 2024, the 50% deduction for Quebec provincial income tax purposes would be reduced to 1/3 to parallel the Federal changes.

³ If identical securities are owned at the time the option shares are donated, the order of disposition of identical securities must generally be designated in order to claim this additional deduction.

⁴ Assumed tax savings, provided the individual is subject to the top Federal tax bracket (at an assumed combined 50% tax rate), has made other donations of at least \$200 in the year and has sufficient other income to avoid the limit on donation claim to 75% of net income (100% in the year of death). The example also assumes the shares exercised (and donated) will qualify for the 50% deduction (in light of the tax rules applicable to stock options issued after June 30, 2021) and the investment security retains the same value at exercise as when donated.

⁵ Assumes individual's aggregate stock option benefit and net capital gains realized in the year do not exceed \$250,000, such that the 50% inclusion rate applies (vs. 2/3). Where the 2/3 inclusion rate applies to the stock option benefit (i.e., only 1/3 deduction), the additional deduction for donating the shares or proceeds acquired through an employee stock option exercise increases to 2/3 to fully offset the stock option benefit, if all of the shares/proceeds are donated.

⁶ With the donation of option shares, while this additional deduction may reduce the net taxable amount in respect of a stock option benefit to \$nil, an employer may still be required to withhold tax on this amount.

⁷ Assumes Alternative Minimum Tax (AMT) does not apply. Please see our publication *Alternative Minimum Tax* for further details.

⁸ With the donation of the cash proceeds through a cashless exercise, withholding tax is not required in respect of this additional deduction. However, an employer may still be required to withhold tax on the net taxable amount. Please consult with your employer's payroll department to confirm the applicable treatment in your particular situation.

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