

Surrender Payment for Stock Options - Character of Receipt

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Rogers Estate v The Queen, [2014 TCC 348](#)

The Estate of the deceased received a surrender payment for surrendering options granted under an employee stock option plan. The issue was the characterization of the surrender payment for income tax purposes.

The taxpayer reported the amount as a capital gain. The MNR included the full amount in income as either (1) income from employment under section 5 or 6(1)(a); (ii) a shareholder benefit under subsection 15(1); or (iii) profit from an adventure in the nature of trade under subsection 9(1).

SUMMARY

The Court held that:

- A court is not bound by an abandonment of an issue by the parties where the issue is one of law or mixed fact and law;
- A court is not bound by an agreed statement of facts, as it must make findings of fact on all of the evidence;
- Section 7 is a complete code on dealing with employee benefits under or because of a stock option plan, excluding the application of sections 5 and 6;
- An employee stock option plan cannot result in a shareholder benefit under 15(1);
- The holding and disposing of an employee stock option plan can be an adventure of concern in the nature of trade, only if the conditions for an adventure of concern in the nature of trade are met;
- Capital gains result from the disposition of ANY property (not just capital property) that are not excluded property; and
- In this case the surrender payment was a capital gain, as it did not fall within section 7, or subsections 15(1), or 9(1).

FACTS

The Deceased was the CEO and President of the issuing corporation, and they did not deal with each other at arm's length. He was issued options under the corporation's employee stock option plan. The options had later attached to them a share appreciation right that, if exercised, would result in a cash payment equal to the difference between the day's average trading price and the exercise price of the option. The share appreciation right could be refused by the corporation, forcing the option holder to exercise the option.

PRELIMINARY MATTER

The Crown abandoned its argument on the "profit from an adventure in the nature of trade" argument but the Judge, after asking for submissions as to whether he was bound by the abandonment, decided to proceed and consider the abandoned argument on the facts presented at trial.

The Taxpayer argued that the Court could not consider the section 9 argument because it was abandoned by the Crown, was incompatible with the agreed statement of facts, and was an usurpation of the MNR's assessment power (para 11).

The Crown argued that a Court may reject a party's abandonment of argument, relying on the decision in *Labourer's International Union of North America, Local 527, Members' Training Trust Fund v. Canada*, 92 DTC 2365, where it was said:

Parties to an action may agree on certain facts and this agreement may form the basis for a judicial admission by which the presiding judge will be bound. Parties cannot, however, make a judicial admission on a point of law, because "the Court may not be bound by error in an admission by the parties as to the law..." The court is not bound by concessions on points of law. . . .

The Court noted that there was no stated assumption of fact that the surrender payment was received qua employee. The court highlighted the importance of not conflating the granting of the option (one event) with the payment of the surrender amount on surrender (second event), as these are distinct and capable of distinct characterization (para 14).

Additionally, the court noted that it is not bound by the Agreed Statement of Facts, but has a duty to make factual findings on the basis of the documentary evidence and the discover readings. (para 15). *Lipson v Canada*, [2009 SCC 1](#), does not apply to prevent a court from considering an issue that is plead where the matter is a mixed question of fact and law, as the court is not bound by any party's interpretation of a point of law (para 19).

Adventure in the nature of trade

A question of mixed fact and law that considers factors - see *Friesen v. Canada*, [\[1995\] 3 S.C.R. 103](#) - including:

- the nature of the property
- the length of the period of ownership
- the frequency or number of other similar transactions by the taxpayer
- the circumstances responsible for the sale of the property
- the taxpayer's motive in acquiring the asset

The FCA in *Baird v. Canada*, [2010 FCA 35](#), dealt with the issue in respect of disposition of shares of a public company, and held that losses on the exercise of employee stock options were on capital account. An "adventure of concern in the nature of trade" is "an isolated transaction (which lacks the frequency or system of a trade) in which the taxpayer buys property with the intention of selling it at a profit and then sells it (normally at a profit, but sometimes at a loss)." (para 56). The intention to sell the shares at a profit is not determinative: *Irrigation Industries Ltd. v. Minister of National Revenue*, [[1962](#)] [S.C.R. 346](#) .

The facts of this case, in light of the above factors, lead the court to conclude that the dealing in the shares were not an adventure or concern in the nature of trade.

Employees' Taxable Benefit

The court next considered whether the carve-out in paragraph 7(3)(a) applied to prevent a surrender payment from being a taxable benefit under section 6, even-though the non-arm's length relationship makes the taxpayer not taxable under section 7.

Section 7 deals with taxation of benefits derived by employees from exercise or dispositions of stock options, and it is meant to, *inter alia*, defer recognition of the income until the amount is received in its entirety and is quantifiable (para 28). It is a complete scheme for taxation of employee stock options, and operates in the particular circumstances in stead of section 6 - See *MNR v Chrysler Canada Ltd et al*, 92 DTC 6346, where it is said that a specific provision trumps general one. Specifically, paragraph 7(1)(b) sets out the rules when an employee disposes of right to shares and takes cash, but applies only to employee's who are dealing at arm's length.

The appellant argued that since the payment is not caught by 7(1)(b), it is not benefit to the taxpayer, and relied on the FCA decision in *Canada v. Quinco Financial Inc*, [2014 FCA 108](#) , where it was held that where a provision is "precisely worded, clear and unambiguous" it must be given effect even if resulting in a windfall. In support the appellant argued that amendments adding 7(1)(b.1) in 2010 now close this loophole, which confirms that no other provision in section 7 applies to the surrender payments (para 40).

The Crown argued that a benefit not caught by section 7 must be included in income under section 6, relying on *Dundas v MNR*, 90 DTC 1529, where it was stated that an employee benefit not caught by section 7 is taxable under section 6.

The court noted that just because the payment was not captured by 7(1)(b), did not mean that 7(3)(a) was not applicable. Paragraph 7(3)(a) is applicable to taxation of benefits arising under or because of stock option agreements, and is clear and unambiguous. It specifically states that unless section 7 captures the benefit of a non-arm's length person, it is not benefit taxable qua employee.

The amount was also not considered to be "other remuneration" under subsection 5(1). The Court sated that "salary" and "wages" connote periodic and fixed payments for work done or services rendered, and other remuneration must (following the specific enumerations) fall within

this meaning- surrender payments do not. In *Hale v. The Queen*, 90 DTC 6481 (FCTD), affirmed 92 DTC 6473 (FCA), and *Hurd v. The Queen*, [1982] 1 FC 554, it was stated that "other remuneration" are sums of money received in return for services and not a benefit of employment (para 47).

Shareholder Benefit

In *Del Grande v. The Queen*, 93 DTC 133, where amounts received on exercise of options were not shareholder benefits within the meaning of 15(1)(c), but rather a benefit by virtue of being an officer or employee. The Court held that the surrender payments were not shareholder benefits under 15(1).

Capital Gains

The Court held that the surrender payment was for a disposition of property, that was not excluded property (subsection 39(1)), and resulted in a capital gain. The Court noted that a capital gain is NOT limited to gains on disposition of capital property, but gains on the disposition of ANY non-excluded property.

-Sas Ansari, JD LLM PhD (exp)

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