



Beyond Stock Options – Restricted Share Unit Plans and Deferred Share Unit Plans

OCRI – 45th Circuit

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Overview

- Restricted Share Unit (“RSU”) and Deferred Share Unit (“DSU”) Plans are employee cash compensation arrangements with the following two characteristics:
 - Tax on the compensation is deferred until the year in which the recipient employee actually receives the payment;
 - The amount of the compensation is based on the share value of the employer Company or a related Company

Salary Deferral Arrangements (“SDAs”)

- It is important that the RSU or DSU Plan not be a SDA. If a plan falls within the SDA definition, the deferred amount is required to be taxed in the hands of the employee *immediately* rather than upon actual receipt in the subsequent year.
- If an amount has been included in the employee’s income and is later forfeited, the employee can claim a deduction in respect of the amount in the year of forfeiture

Restricted Share Units

- RSUs represent an entitlement to a bonus which based, in some manner, upon the value of the Company's Shares (i.e. can be based on share price or on future appreciation)
- Employees do not actually own or have a right to own Shares – therefore no rights as shareholders
- Appropriate for employees and directors (who are deemed to be employees for tax purposes)

Restricted Share Units

- If RSU entitles employee to receive the increase in underlying share value (from date the RSU is granted), the CRA has confirmed that the benefit of the RSU is not an SDA as it relates to future service not past service

(Q 26, 1988 CRA Round Table & TI – 2001-0067027)



Restricted Share Units

- If RSU entitles employee to receive the value of a share, then generally the RSU must “vest” within 3 years of the end of the year in which the RSU is granted in order to avoid SDA rules

Therefore a grant in January, 2007 must vest by December 31, 2010

Restricted Share Units

- Common RSU Plan features:
 - RSUs can be “vested” or “unvested”
 - If unvested, number of RSUs that vest can depend upon a variety of factors, such as individual performance, performance of a division or group or performance of Company as a whole (“performance factors”)

Restricted Share Units

- Common RSU Plan features:
 - If dividends are paid on shares while RSUs are outstanding, often additional RSUs (“dividend equivalents”) will be granted equal to amount of dividend
 - Bonus becomes payable on vesting date

Restricted Share Units

- Example 1 - Calculation of bonus based on share value:

*Amount of bonus = # of vested RSUs x
share price on vesting date*

- Example 2 – Calculation of bonus based on the increase in share value:

*Amount of bonus = # of vested RSUs x
[share price on payment date – share
price on grant date]*

Restricted Share Units

- **Common RSU Plan features:**
 - RSU Plans generally include provisions dealing with what happens to unvested RSUs upon termination (with and without cause), resignation, death, retirement, disability, etc.
 - Consider vesting if change of control of company (i.e. acquisition of company) – should vesting of RSUs be accelerated?

Restricted Share Units

■ Tax Treatment:

- Employee taxed on cash bonus payment in year of receipt – treated as regular income
- Company receives deduction
- Payment subject to normal statutory withholdings

(See IT 113R4 and ATR 64)

Restricted Share Units

- Conversion Options:
 - Unvested RSUs can be converted into Stock Options
 - Careful on the conversion to make sure requirements of para. 7(3)(a) are met
(See CRA views: TI – 2001-0067027 for conversion of an appreciation type plan and TI – 2003 – 0043361R3)
 - Note: 110(1)(d) deduction may not be available, consider 110(1)(d.1)

Restricted Share Units

■ Share Payment Options

- If RSU Plan so provides, can pay “net” bonus amount (after tax deductions) in shares - employee receives high adjusted cost base in shares, any future gain/loss will be on account of capital
- Note: care must be taken to ensure Company obtains deduction for payment – para 7(3)(b)

(See CRA TI – 2003-0049927)

Restricted Share Units

■ Tips & Traps:

- Need to have a mechanism to value Company shares as of relevant dates (vesting date, etc.); however, valuation methods are more flexible for some RSU Plans and need not be “spot on”
- Where a Company has different classes of Shares, must decide to which class of Shares the RSUs will “track”

Deferred Share Units

- DSUs represent an entitlement to a payment on retirement or loss of employment (Reg. 6801(d))
- DSU entitlement must reasonably be attributable to duties of an office or employment
- Used as additional incentive or as a means of deferring salary until retirement

Deferred Share Units

- Based upon the fair market value (“FMV”) of shares of employer Company or related Company at that time
- The payment must be made by the end of the year following retirement or loss of employment (I.e. for retirement in 2006, payment must be made by end of 2007)
- Must be agreement in writing

Deferred Share Units

- Payment based on FMV of company shares (or shares of a related company)
- FMV of shares must be determined at a point in time between:
 - One year before the date of retirement, loss of employment and
 - The date the payment is received

Deferred Share Units

- Accurate FMV determination is necessary to qualify as prescribed plan.
- CRA views FMV as:

“... the highest price available in an open and unrestricted market between informed, prudent parties acting at arm’s length and under no compulsion to act, expressed in terms of money or money’s worth”

Deferred Share Units

- Cannot provide a minimum share value guarantee to employees – if share value goes down from date of grant, employees cannot be compensated for the “loss”
- Sometimes additional DSUs are granted as dividends are paid on the Company Shares (“dividend equivalents”)

Deferred Share Units

- **Tax Treatment:**
 - Employee taxed on cash payment in year of receipt – treated as regular income
 - Company receives deduction
 - Payment subject to normal statutory withholdings

Deferred Share Units

- **Tips and Traps:**
 - Employee can be given the choice as to whether he takes cash bonus payable immediately or DSUs
 - Employee can be given the choice as to whether he takes RSU entitlement or DSU
 - In both cases, employee must elect prior to becoming entitled to receive cash bonus or vested RSUs

Deferred Share Units

- Tips and Traps:
 - Be careful not to segregate funds for DSU entitlements, as this could inadvertently result in a retirement compensation arrangement (subject to Part X1.3 tax)
 - If Plan provides, may be able to pay out “net” bonus amount (after tax deductions) in shares - employee receives high adjusted cost base in shares, any future gain/loss will be on account of capital



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Thank You!