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Tax Alert — Canada

Finance confirms employee stock option change deferred to 2026

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 7 February 2025, the Department of Finance confirmed with EY tax professionals that the deferral of the proposed increase in the capital gains inclusion rate extends to all proposed consequential amendments to the *Income Tax Act*, including the proposed amendments to the employee stock option deduction.

On 31 January 2025, the government announced that the proposed increase in the capital gains inclusion rate from one-half to two-thirds, for capital gains exceeding $250,000 annually for individuals and all capital gains realized by corporations and most types of trusts, will be deferred from 25 June 2024 to 1 January 2026.[1]

The employee stock option deduction is intended to reflect the capital gains inclusion rate so that employee stock options that meet certain conditions are effectively taxed at the same rate as capital gains. Therefore, the draft legislation that included the proposed increase in the capital gains inclusion rate to two-thirds also proposed a corresponding reduction in the employee stock option deduction from one-half to one-third. As expected, the government has confirmed that the implementation of the corresponding proposed changes to the employee stock option deduction is also deferred until 1 January 2026.

Except in the case where options exercised were granted for shares of a Canadian-controlled private corporation, income tax must be withheld on the employment benefit received on the exercise or disposition of an option. The employee stock option deduction can be taken into account in determining the amount of income tax to withhold where the stock options meet the necessary conditions to qualify for the employee stock option deduction.

[1] For more information, see EY Tax Alert 2025 Issue No. 6, *Federal government announces deferred implementation date of the capital gains inclusion rate change*.

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As a result of the deferral of the implementation date, a stock option deduction of one-half can be used for purposes of determining the amount of income tax to withhold for employee stock options exercised or disposed of in 2025 that qualify for the stock option deduction.

Further, due to the recent changes and ongoing challenges for those filing information returns, on 19 February 2025, the Canada Revenue Agency (CRA) announced that it will not assess late-filing penalties for information returns that are normally due on 28 February 2025, provided the information returns are filed by 7 March 2025. If the T4 information return is not filed by 7 March 2025, late-filing penalties will be applied on the basis of the original 28 February due date (i.e., if the T4 information return is filed on 8 March 2025, it will be considered to be eight days late).

Note that the CRA also announced an extended period of relief from late-filing penalties in circumstances where information reported on certain information returns needs to be recalculated as a result of the deferred implementation of the increase in the capital gains inclusion rate. The extended relief period ends on 17 March 2025. At the time of writing, it was unclear whether this further extension would apply to T4 information returns requiring the recalculation of employee stock option deductions.

Revenu Québec administers taxation separately for the province of Quebec. For stock options that qualified for the one-half employee stock option deduction for Quebec tax purposes, Quebec has indicated that this one-half stock option deduction will continue to apply to stock options exercised or disposed of before 1 January 2026.

At the time of writing, Revenu Québec has not announced late-filing penalty relief with respect to information returns.

Learn more

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