



Wealth
Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES



Dann Cushing, CFA, FCSI
Portfolio Manager & Wealth Advisor
Tel: 416-842-7942
dann.cushing@rbc.com

Employee compensation — employee share purchase plans

As an employee, you may be compensated in a number of ways. Your remuneration may include salary, a bonus and equity-based compensation, for example. This article discusses the features and tax implications of employee share purchase plans (ESPPs), which are one type of equity-based compensation. ESPPs are also sometimes referred to as “employee stock ownership plans” or “employee stock purchase plans.”



Gregory Johnston, CFA
Associate Investment Advisor
Tel: 416-974-7576
gregory.johnston@rbc.com

Cushing Private Wealth Partners
of RBC Dominion Securities
181 Bay St, 22nd Floor
Bay-Wellington Tower
Toronto, ON M5J 2T3
cushingwm.com

What is it?

An ESPP is a program offered by your employer that allows you to purchase shares of the company, usually for fair market value (FMV). Purchases are made using your after-tax funds and are usually done through payroll deductions from your regular pay or at scheduled times throughout the year, as a lump-sum purchase from a single pay period.

Often, employers will offer incentives to encourage you to participate in the ESPP. Incentives may include your employer matching a certain portion of your contributions to purchase the shares. An example of matching is where you make a contribution to the

plan based on a percentage of your pay and your employer contributes half of what you contribute. The ESPP then purchases shares for you with both your contributions and your employer’s contributions.

Alternatively, the plan may allow you to purchase the shares at a discount as an incentive to participate in the ESPP. That being said, however, this second option isn’t as common in Canada because of the less favourable tax treatment (and is therefore not discussed in this article).

Once the shares are purchased, you have the right to vote the shares and receive dividends, but you may be

restricted from selling, transferring or assigning them until after the vesting period (the set period of time you need to work for your employer before you fully own the shares in the plan), which is usually about a year.

If a company's shares meet the conditions for being qualified investments in a registered plan, an ESPP may allow contributions to be directed to and shares to be purchased in a Registered Retirement Savings Plan (RRSP) or a Tax-Free Savings Account (TFSA). Keep in mind that it's your responsibility to ensure you have sufficient contribution room if you're directing your contributions to your RRSP and/or TFSA.

Why is it used?

Companies use ESPPs to give you a long-term stake in the company; this in turn allows you to experience the risks and rewards of ownership and aligns your objectives with company and shareholder objectives. For employers, the general hope is that participating in an ESPP may encourage you to consider the long-term success of the company since you stand to benefit if the value of your shares increases, as well as from annual dividends. For you as the employee, ESPPs may provide an incentive and a method to save for the future.

How is it taxed?

To the employee

Non-registered accounts

With an ESPP, you would be taxed on your contributions from payroll deductions as well as your employer matching contributions. The funds contributed to the plan by you and your employer would be treated as your taxable employment income.

Once the shares are purchased, the taxation of the shares is like any other share investment. Any dividends paid on your shares in the plan would be included in your income for the year, regardless of whether the dividends are distributed out of the plan to you in the year. In addition, any dispositions of your shares (e.g. selling, assigning or transferring them) within the plan would be a taxable event and you would have to report a capital gain or loss, even if the funds aren't withdrawn from the plan. In determining your capital gain or loss, the adjusted cost base (ACB) of your shares will generally be the fair market value (FMV) of the shares at the time you purchased them. However, keep in mind that when you purchase identical shares at different times, there is an averaging rule which requires the ACB to be averaged amongst all of the identical shares you hold in non-registered accounts at that time. Generally, this means the ACB of your shares

Companies use ESPPs to give you a long-term stake in the company; this in turn allows you to experience the risks and rewards of ownership and aligns your objectives with company and shareholder objectives.

would be the total amount paid for all of your shares divided by the total number of shares owned.

Registered accounts

Your ESPP may allow you to direct some or all of your contributions to an RRSP or TFSA account where the shares are then purchased inside your registered plan. The funds contributed to the plan by you and your employer would be treated as your employment income, which

is reported to you on a T4 slip. Your employment income would generally be subject to income tax withholding at source. However, where your contributions are directed to your RRSP, your employer may not withhold income taxes at source.

Your contribution to these registered plans will be limited by your RRSP and TFSA contribution room, respectively. A contribution receipt will be issued for any RRSP contributions made and these are deductible in calculating your taxable income.

Dividends paid on any shares held in your RRSP or TFSA will not be taxed when received in your registered plans. Also, any shares you sell inside your RRSP or TFSA are not subject to income tax at the time of disposition.

The full amount of any funds withdrawn from your RRSP is taxable in the year withdrawn and will be reported to you on a T4RSP slip. You can withdraw funds from your TFSA tax-free.

To the employer

Your employer should be able to claim a deduction for contributions to the ESPP since these amounts represent your compensation, which you directed towards purchasing company shares. However, the deduction is only available to your employer if the company shares are purchased on the open market by the trustee of the ESPP. If instead the trustee of the ESPP purchases treasury shares from the company, your employer would not be able to claim a deduction.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



Wealth
Management

This document has been prepared for use by the RBC Wealth Management member companies, RBC Dominion Securities Inc. (RBC DS)*, RBC Phillips, Hager & North Investment Counsel Inc. (RBC PH&N IC), RBC Global Asset Management Inc. (RBC GAM), Royal Trust Corporation of Canada and The Royal Trust Company (collectively, the "Companies") and their affiliates, RBC Direct Investing Inc. (RBC DI) *, RBC Wealth Management Financial Services Inc. (RBC WMFS) and Royal Mutual Funds Inc. (RMFI). *Member-Canadian Investor Protection Fund. Each of the Companies, their affiliates and the Royal Bank of Canada are separate corporate entities which are affiliated. "RBC advisor" refers to Private Bankers who are employees of Royal Bank of Canada and mutual fund representatives of RMFI, Investment Counsellors who are employees of RBC PH&N IC, Senior Trust Advisors and Trust Officers who are employees of The Royal Trust Company or Royal Trust Corporation of Canada, or Investment Advisors who are employees of RBC DS. In Quebec, financial planning services are provided by RMFI or RBC WMFS and each is licensed as a financial services firm in that province. In the rest of Canada, financial planning services are available through RMFI, Royal Trust Corporation of Canada, The Royal Trust Company, or RBC DS. Estate and trust services are provided by Royal Trust Corporation of Canada and The Royal Trust Company. If specific products or services are not offered by one of the Companies or RMFI, clients may request a referral to another RBC partner. Insurance products are offered through RBC Wealth Management Financial Services Inc., a subsidiary of RBC Dominion Securities Inc. When providing life insurance products in all provinces except Quebec, Investment Advisors are acting as Insurance Representatives of RBC Wealth Management Financial Services Inc. In Quebec, Investment Advisors are acting as Financial Security Advisors of RBC Wealth Management Financial Services Inc. RBC Wealth Management Financial Services Inc. is licensed as a financial services firm in the province of Quebec. The strategies, advice and technical content in this publication are provided for the general guidance and benefit of our clients, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. This publication is not intended as nor does it constitute tax or legal advice. Readers should consult a qualified legal, tax or other professional advisor when planning to implement a strategy. This will ensure that their individual circumstances have been considered properly and that action is taken on the latest available information. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This information is not investment advice and should only be used in conjunction with a discussion with your RBC advisor. None of the Companies, RMFI, RBC WMFS, RBC DI, Royal Bank of Canada or any of its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. ®/™ Registered trademarks of Royal Bank of Canada. Used under licence. © 2021 Royal Bank of Canada. All rights reserved. NAV0210 (01/19)