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EMPLOYEE STOCK OPTIONS

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on the potential liability of a corporation's directors under the Income Tax Act (Canada) and other taxation statutes. Alpert Law Firm is experienced in providing legal services to its clients in tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions and estate administration.

A. TAXABLE EMPLOYMENT BENEFIT

Section 7 of the *Income Tax Act* (the "Act") governs the taxation of employee stock options, and is applicable to options granted to an employee to acquire securities of (i) an employer corporation, (ii) an employer mutual fund trust, or (iii) a corporation or mutual fund trust not dealing at arm's length with the employer. The Act refers to these entities as "qualifying persons", which is defined to include a corporation or a mutual fund trust. "Security" is defined as a share of the capital stock of the corporation or unit of a mutual fund trust.

An employee of a publicly traded corporation who acquires securities of his employer pursuant to an employee stock option agreement is generally deemed to receive a taxable employment benefit. As well, the employee is generally required to include in income an employment benefit equal to the difference between the fair market value of the stock at the time the stock option was exercised and the amount paid by the employee to acquire the stock option.

Subparagraphs 7(1)(a) to (e) of the Act lists the following circumstances in which an employee is deemed to have received a benefit by virtue of employment:

(i) Acquiring Securities Under an Agreement

If an employee acquires securities under an agreement, whereby the employer agrees to sell or issue securities of the employer, the employment benefit is deemed to have been received in the year in which the securities are acquired. However, if either subsection 7(1.1) or (8) of the Act applies, then the benefit is deemed to have been received in the year in which the employee disposes of the securities. Pursuant to

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subparagraph 53(1)(j) of the Act, the amount of the deferred benefit is added to the adjusted cost base of the securities at the time of acquisition.

Under subsection 7(1.1) of the Act, a deferral is available for stock options granted by a Canadian Controlled Private Corporation ("CCPC"), on the condition that immediately after the option is granted, the employee deals at arm's length with the employer. The deferral still applies even if the employer, while having CCPC status at the time the option was granted, ceases to be a CCPC prior to the time the securities are issued under the agreement. Furthermore, pursuant to subsection 110(d.1), if the employee does not dispose of or exchange the securities within two years of acquiring them, then the employee is permitted to deduct one-half of the benefit from income.

Under subsection 7(8) of the Act a deferral of an employment benefit is available for options to acquire publicly-listed shares or units in mutual fund trusts. Such deferral applies to any "qualifying acquisition" of a security, a term which is defined in subsection 7(9) of the Act. This deferral is elective at the option of the employee, who must be a resident in Canada at the time of the acquisition of the security. However, it is important to note that the election must be made in respect of each security for which the deferral is sought. For options that vest or become exercisable in a particular year, subparagraph 7(10)(c) of the Act provides for an annual vesting limit, under which the election to defer the benefit resulting from the exercise of the option is limited to $100,000 worth of securities acquired under the options. The employee must file an election with the employer before January 16 of the year following the year in which the security is acquired. But such election can be revoked, if done so by January 15 of the year following the year in which the security is acquired . An employee may want to revoke an election to apply the vesting limit to other securities acquired that may have a larger deferred benefit.

(ii) Transfer or Disposition of a Right to Acquire Securities to Arm's Length Party

Under subparagraph 7(1)(b) of the Act, if an employee transfers or disposes of a right to acquire securities to an arm's length person, then the employment benefit is deemed to be received in the taxation year in which the employee made the disposition. However, subparagraph 7(1)(e) of the Act provides that this rule does not apply where the disposition was a result of the employee's death. Instead, the benefit would be deemed to be received in the year of the employee's death, and is deemed to be the amount by which the value of the right immediately after the death exceeds the amount the employee paid to acquire the right.

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(iii) Transfers of a Right to Acquire Securities

Under subparagraph 7(1)(c) of the Act, if the employee's right to acquire securities is transferred by one or more transactions between non-arm's length persons and the transferee has acquired securities under the agreement, the employment benefit is deemed to be received by the employee in the tax year in which the transferee of the right acquired the securities, regardless of the time of payment. However, if the employee is deceased at the time the transferee acquires the securities, then the benefit is deemed to have been received by the transferee in that year as employment income. Such income is deemed to be earned in the country where the employee, who transferred the securities, primarily performed the employment duties.

Pursuant to subparagraph 7(1)(d) of the Act, if the employee's right to acquire securities is transferred by one or more transactions between non-arm's length persons to a transferee, who then disposes of the right to a person with whom the transferee was dealing at arm's length, then the employment benefit will be deemed to be received by the employee in the tax year in which the arm's length disposition was made. If the employee is deceased at the time, the above-mentioned rule applies.

(iv) Corporate Reorganizations or Amalgamations

Where an employee disposes of an option to acquire securities in exchange for another option pursuant to a corporate reorganization or amalgamation, then the rollover provisions in subsection 7(1.4) of the Act may apply. Pursuant to the rollover provisions, the following rules apply: (i) no disposition is deemed to have occurred; (ii) the new option would be the same as the original option; (iii) a deemed taxable benefit will not arise; and (iv) the deduction under subparagraph 110(1)(d) of the Act still applies. In order for the rollover to apply, the following conditions must be met:

(i) The employee must receive no consideration for the old option other than the new option, and

(ii) The fair market value of the new securities immediately after the exchange in excess of the old exercise price must not exceed the fair market value of the old securities immediately before the exchange in excess of the new option exercise price.

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B. RECENT CHANGES

On March 4, 2010, the 2010 Federal Budget was released, wherein amendments to certain employee stock option provisions were announced. On December 15, 2010, Bill C-47 was enacted to include such amendments, which are described below.

(i) Stock Option Cash-Out Payments

Many employee stock option agreements provide cash-out rights, whereby the employee can elect to receive a cash payment (equal to the employee stock option benefit) instead of the shares at the time the option is exercised. Previously, the employee was eligible to receive the 50% reduction of the employee stock option benefit pursuant to subsection 110(1)(d) of the *Act* and the employer was entitled to claim a 100% corporate level deduction in respect of the cash payment pursuant to subsection 7(3)(b) of the *Act*.

Pursuant to Bill C-47, an employee will only be eligible to receive the 50% reduction of the employee stock option benefit after 4:00 p.m. EST on March 4, 2010 if the employer files a prescribed election agreeing to forgo claiming a corporate level deduction for the cash-out payment. This change will present immediate concerns for employees and employers, equally. For employees, they must be cognizant of the fact that if they elect to exercise a cash-out right, they will not be eligible to claim the 50% deduction unless the employer elects to forgo its deduction for the cash-out payment. For employers that provide cash-out rights, they will need to reassess whether they are prepared to forgo the cash-out payment deduction or whether they will eliminate outstanding cash-out rights and not provide new options with such rights.

(ii) Elimination of Tax Deferral Election

Previously, an employee of a publicly traded corporation was able to elect to defer the taxation of his employee stock option benefit until the disposition of the optioned securities (or was deemed to have disposed of the shares on death, or on becoming a non-resident of Canada). Bill C-47 repeals this tax deferral election for employee stock options exercised after 4:00 p.m. EST on March 4, 2010.

Bill C-47 also proposes special relief for those individuals who elected to defer taxation of their employee stock option benefits until the disposition the optioned securities and found themselves in the situation where the value of the optioned securities was less than the deferred tax liability resulting from the exercise of the

options. Where an employee is required to include in income a qualifying deferred stock option benefit, the employee can elect to pay a special tax equal to the full proceeds of disposition of the optioned securities instead of the amount that would otherwise have been payable in connection with the exercise of the optioned securities. This special election is intended to apply to the disposition of optioned securities before 2015. However, an employee who disposed of their optioned securities before 2010 was required to make the special election on or before their filing due-date for the 2010 taxation year (typically, April 30, 2011).

(iii) Remittance Obligations

Pursuant to Bill C-47, the provisions of subsection 7(1) of the Act will subject an employee stock option benefit to withholding tax requirements as if the benefit was a cash bonus payment. As a result, an amount in respect of tax on the employee stock option benefit will be required to be remitted to the government of Canada by the employer. An employee will no longer be able to claim "undue hardship" pursuant to the provisions section 153 of the *Act* as a result of the employee's inability to meet the tax obligation associated with the employee stock option benefit due to a subsequent decrease in the value of the optioned securities. Consequently, the Minister will no longer have a discretion to reduce the amount of withholding tax on the basis of claim made by an employee for "undue hardship" pursuant to the provisions of section 153 of the *Act*.

This measure will not apply to employee stock options granted before 2011 pursuant to a written agreement entered into before 4:00 p.m. EST on March 4, 2010 where the written agreement includes a condition restricting the employee from disposing of the shares for a period of time after exercise.

C. CASE LAW

1. *Taylor v. The Minister of National Revenue*, 88 DTC 1571

In this Tax Court of Canada case, the taxpayer was a director of two corporations (“Bianca” and “Greenwood”). Bianca granted the taxpayer an option to acquire 50,000 shares of the company at $2.70 per share. The taxpayer exercised this right, and purchased 20,000 shares valued at $5.40 at that time, and later 30,000 shares valued at $4.40 at that time. Greenwood granted the taxpayer an option to acquire 15,000 shares of the company at $3.75 per share. The taxpayer exercised this option when the

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value of each share was $16.50. In addition, the taxpayer received 50,000 shares in Bianca from Treasury in consideration for several mining claims which the taxpayer owned and transferred to Bianca. These shares were subject to an escrow agreement that provided that (i) the taxpayer was prohibited from dealing with the shares in any manner without the consent of the Superintendent of Brokers of British Columbia, and (ii) the shares were to be tendered to the company by way of gift if the mining claims diminished in value, or if the company failed to acquire title to the mining claims.

The Minister assessed the taxpayer pursuant to subsection 7(1) of the Act, on the basis that the taxpayer was a director of Bianca and Greenwood and received stock option benefits by virtue of his employment as a director of the corporations. The Minister also deemed the escrow shares to be identical properties to the option shares. The taxpayer appealed the assessment, on the basis that (i) he was not an employee within the ambit of the Act, and (ii) even if he was an employee, he did not receive the benefit “by virtue of his employment” as required by subsection 7(5) of the Act.

The Tax Court held that while the escrow shares were not identical to the option shares, the benefits the taxpayer received by exercising the option shares were taxable pursuant to subsection 7(1) of the Act. The Tax Court held that the taxpayer was an employee, on the basis that a directorship is an office, and the holder of an office is an officer, and thus an employee. Furthermore, the Tax Court determined that the absence of remuneration is not determinative of the nature of the relationship and an individual can be an employee despite not being paid.

In regards to the taxpayer’s second argument, the Tax Court stated that in order for a benefit to be regarded as having occurred “by virtue of employment”, there must be a substantive justification for deciding that a benefit accrues to an employee as a direct result of the services which he performs. The taxpayer argued that the benefit he received (i.e. the options) resulted from the companies’ desire to enhance their reputations by virtue of their association with him acting as a director, and thus, not a service which he performed that would be subject to tax under section 7 of the Act. The Tax Court rejected this argument and held that the taxpayer was “hired” as an employee to perform as a director and their relationship was structured in this manner. Thus, the benefits the taxpayer received by the exercise of his rights under the option agreements were taxable pursuant to subsection 7(1) of the Act.

2. *The Queen v. Placer Dome Inc.* 92 DTC 6402

In this Federal Court of Appeal decision, the corporate taxpayer made available a complex and sophisticated stock purchase plan (the “Plan”) to all of its employees. The

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Plan was a trusteed plan, under which employees were permitted to contribute up to six percent of their salary for the year. The corporate taxpayer and affiliated companies would then contribute an amount equal to one half of the employee's contribution. The trustee then used the contributions to purchase, at market value, shares of the corporate taxpayer from other Plan members or from the corporate taxpayer's treasury. In computing its income for 1985, the corporate taxpayer deducted the contributions it had made to the Plan during that year, namely $282,876.

The corporate taxpayer submitted that the contributions under the Plan were made as additional remuneration to the participating employees, and thus: (i) they constituted taxable income in the hands of the employees pursuant to the general provision of subsection 5(1) of the Act; and (ii) they were deductible from the employer's own taxable income. However, the Minister argued that the employer's contributions were provided merely to allow the acquisition of shares by the employees at a reduced price, and thus, was governed by section 7 of the Act. The Minister submitted that subparagraph 7(1)(a)(ii) and subsection 7(3) of the Act superceded the general provision of section 5 and rendered the contributions taxable in the hands of the employees, but not deductible by the employer.

The trial judge agreed with the taxpayer, and the Minister appealed. At the Federal Court of Appeal, the Minister's appeal was allowed based on the following facts: (i) the trustee was merely a conduit through which the employer administered the Plan; (ii) the employees never received money or money's worth until termination or withdrawal and, even then, never from the employer directly; and (iii) the funds payable by the employer to the trustee each month had a predetermined destination and never fell under any real control or genuine power of the employees or the trustee.

The Federal Court of Appeal concluded that the true benefit the employees acquired by their participation in the Plan was not the entitlement to an additional remuneration, but the entitlement to a credit for shares of the corporate taxpayer at two-thirds of their market value. The Federal Court of Appeal stated that this was equivalent to a corporation selling its treasury shares at a discount to the employee. Therefore, as the benefits accrued to the employees under the Plan were taxable pursuant to paragraph 7(1)(a) of the Act, subsection 7(3) of the Act precluded the taxpayer from deducting its contributions.

3. ***Buccini v. The Queen*, 2000 DTC 6685**

In this Federal Court of Appeal decision, the taxpayer was an employee with corporation that amalgamated with its majority shareholder. Pursuant to the

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amalgamation plan, all the outstanding options to purchase stock in the corporation were terminated and the option holders were given a release payment as compensation. The taxpayer reported the release payment he received as damages for the unilateral breach of the stock option plan. However, the Minister included the release payment in the taxpayer's income pursuant to paragraph 7(1)(b) of the Act, stating that the payment was either (i) proceeds of the transfer or disposition of rights under a share purchase agreement, or (ii) an employment benefit under subsection 6(1) or (3) of the Act.

The Tax Court of Canada held that the Minister was correct in its reassessment on the basis that (i) the release payment was an employment benefit pursuant to paragraph 7(1)(b); and (ii) the release payment was not considered damages but was a disposition of the taxpayer's right under the option plan. Essentially, the Tax Court held that the taxpayer still had the right to accept the unilateral repudiation, such that the contract was not terminated until the release was signed. The taxpayer appealed.

The Federal Court of Appeal allowed the taxpayer's appeal and stated that the unilateral conduct of the corporation in repudiating the option agreement constituted a fundamental breach of the contract that terminated the contract as of that date, without the need for the taxpayer to accept the breach. As a result, the taxpayer could not be found to have later disposed of these same rights under paragraph 7(1)(b) of the Act.

The Minister also argued that if the payment was not a disposition of rights under the option agreement, then it was taxable as an employment benefit under section 6 of the Act. The Federal Court of Appeal dismissed this argument, stating that damages for breach of contract of employment are not taxable under section 6 of the Act. As to the issue of whether the release payment may reasonably be said to have been "in satisfaction of an obligation arising out of an agreement" made in the course of employment pursuant to subsection 6(3) of the Act, the Federal Court of Appeal held that the payment received arose only indirectly from the taxpayer's employment and the inclusion of such an amount was not contemplated by section 6 of the Act. Therefore, the taxpayer's appeal was allowed and the matter was referred back to the minister for reassessment.

4. ***McAnulty v. The Queen,*** **2001 DTC 942**

In this Tax Court of Canada decision, the taxpayer exercised stock options that she held to acquire 45,000 shares of Bre-X Minerals Ltd. Pursuant to section 7 of the Act, the taxpayer included in her income, the difference between the price paid on the exercise of the options and the fair market value on the exercise date. The taxpayer

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also claimed a deduction of 25% of the taxable benefit pursuant to paragraph 110(1)(d) of the Act, under which the right to claim the deduction is conditional on the option price being not less than the fair market value of the shares at the time of the agreement to issue the shares.

The taxpayer submitted that the relevant date (i.e. the date of the agreement) was April 29, 1994, when the President of Bre-X told the taxpayer that she would be receiving options to purchase 45,000 shares. On that date, the option price was not less than the fair market value of the shares. However, there was nothing in writing at that time. The Minister denied the deduction on the basis that the relevant date was May 19, 1994, when the option agreement was actually signed, and on this date, the option price was less than the fair market value of the stocks. The taxpayer appealed to the Tax Court of Canada.

At the Tax Court, the Minister argued that (i) the words "agree" or "agreement" generally connotes a binding contractual commitment and it is this sense that must be interpreted in paragraph 110(1)(d) of the Act; and (ii) the President of Bre-X did not have the authority to bind the company to issue options because the stock option plan gave the administration of the plan to the Board of Directors who had not yet delegated their powers to him.

The Tax Court allowed the taxpayer's appeal, and held that (i) the law is clear that such an agreement need not be in writing and that a broader approach to the interpretation of "agree" and "agreement" in paragraph 110(1)(d) of the Act is required if the object of that paragraph is to be achieved; and (ii) the President had ostensible authority to commit the company to issue shares under an option agreement and that the taxpayer had no reason to question his authority (i.e. the "indoor management rule" applied). Therefore, the Minister was ordered to reassess.

5. *Alcatel Canada Inc. v. The Queen,* 2005 DTC 387

In this Tax Court of Canada case, the corporate taxpayer maintained an employee stock option program, under which employees had the right to purchase shares of the corporate taxpayer at an exercise price not lower than the market price of the shares on the TSX at the time when the options were granted. Upon exercising their options, the employees derived a benefit equal to the excess of the market value of the shares at the time the stock option was exercised over the exercise price.

At all material times, the corporate taxpayer was engaged in scientific research and experimental development ("SR&ED"), and in its 1994 income tax return, it elected

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to use the proxy method to calculate its SR&ED expenditures. In calculating its 1994 SR&ED expenditures, the corporate taxpayer included the value of stock option benefits derived by those employees who were directly engaged in the prosecution of SR&ED in the amount of approximately $23,345,000 pursuant to subclause 37(8)(a)(ii)(B)(IV) of the Act. Accordingly, the corporate taxpayer claimed an investment tax credit ("ITC") of approximately $4,670,000 with respect to the stock option benefits pursuant to section 127 of the Act. The Minister reassessed the corporate taxpayer, disallowing the ITC claim and reducing the balance of the ITC pool on the basis that the stock option benefits derived by the employees of the corporate taxpayer were not "expenditures incurred" within the meaning of clause 37(8)(a)(ii)(B) of the Act. The corporate taxpayer appealed.

At the Tax Court of Canada, the main issue was whether the benefits conferred on the employees through stock options constituted "expenditures made in respect of an expense incurred in the year for salary or wages" within the meaning of subclause 37(8)(a)(ii)(B)(IV) of the Act. The corporate taxpayer claimed that the benefits did so qualify. However, the Minister argued that: (i) the corporate taxpayer, in allowing its employees to buy shares for less than market value, conferred a benefit on them without making any outlay and therefore did so without making any expenditure; (ii) the outlays, if any, were not "expenditures of a current nature made by the taxpayer" within paragraph 37(1)(a) of the Act because the transactions related not to the corporate taxpayer's income earning process but rather to the corporate taxpayer's share capital structure; and (iii) even if the amount in issue did satisfy the terms of subclause 37(8)(a)(ii)(B)(IV) it cannot be added to the expenditures described in paragraph 37(1)(a) without contravening the prohibition in paragraph 7(3)(b).

The Tax Court allowed the corporate taxpayer's appeal and held that: (i) the meaning of "expenditure" is not confined to outlays of cash; (ii) the Minister failed to recognize that the employees received a real benefit through their stock options, and such stock option benefits fall within the meaning of salary or wages as defined in section 248 of the Act; (iii) the main purpose of the employee stock option program was to compensate the employees for their services and to encourage future effort, and there was no suggestion that the work on which the employees were engaged was aimed in any way at increasing or altering the corporation's capital structure; and (iv) paragraph 7(3)(b) applies to the computation of income only, and does not affect the computation of ITCs.

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6. *Shoppers Drug Mart Limited v. The Queen,* 2008 DTC 2043

In this Tax Court of Canada case, the corporate taxpayer, Shoppers Drug Mart ("Shoppers") was a wholly owned subsidiary of Imasco Limited ("Imasco"). The officers and key employees of Shoppers, as well as those of Imasco and other Imasco subsidiaries, were granted options to purchase Imasco shares. Employees holding vested options could elect to exercise their options and receive Imasco shares upon payment of the option price.

In March 1999, British American Tobacco ("BAT") approached Imasco to discuss a proposal that BAT would acquire the common shares of Imasco held by the public. Prior to entering into an agreement with respect to this proposal, Imasco amended the Imasco stock option plan so that the option holders were given the right to surrender the option for a cash payment equal to the excess of the fair market value of the share over the option price. The transaction was approved in January 2000, and employees of Shoppers either exercised their options to receive Imasco shares or elected to surrender their options for cash, which was paid out by Imasco. Shoppers reimbursed Imasco for said payments, and deducted this amount in computing its income for 1999.

The Minister disallowed the deduction by Shoppers, relying upon the decision in ***The Queen v. Kaiser Petroleum Ltd.* 90 DTC 6603**. In that case, the Federal Court of Appeal stated that the sole question for determination was whether a payment made by the respondent in order to extinguish a stock option plan held in favour of certain of its officers and employees, constituted a deductible expense or an outlay on account of capital. The Federal Court of Appeal held that the payment was on capital account, as the disbursement made was a once and for all payment which had a direct effect on the capital structure of the corporation.

Shoppers appealed the assessment, and in allowing the appeal, the Tax Court of Canada distinguished the case from *Kaiser Petroleum*. The Tax Court stated that the rearrangement of the Imasco corporate structure did not impinge in any way on the corporate structure of Shoppers. In *Kaiser Petroleum*, the cancellation of the stock option plan was an advantage for the lasting benefit of Kaiser Petroleum. However, a payment by Shoppers to Imasco to reimburse it for payments made to employees of Shoppers did not create or achieve anything of lasting benefit to Shoppers. The Tax Court stated that the fact that a subsidiary reimburses its parent for compensation paid to the subsidiary's employees does not turn the payment into a capital expenditure just because the parent company is in the midst of a corporate reorganization.

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7. *Imperial Tobacco Canada Limited v. The Queen,* 2010 TCC 648

In this Tax Court of Canada case, the taxpayer was the successor by amalgamation to Imasco Limited ("Imasco"). In March 1999, British American Tobacco ("BAT"), who indirectly owned 42.5% of the outstanding common shares of Imasco, approached Imasco to discuss a going-private transaction. The transaction entailed BAT acquiring all of the Imasco shares that BAT and its subsidiaries did not hold.

The Imasco employee stock options plan was instituted in 1983, under which holders of vested options could elect to exercise their options to receive common shares of Imasco upon payment of the exercise price. In June 1999, Imasco amended the stock options plan to permit the option holders the discretion to elect to surrender a cash payment equal to the difference between the market value of the Imasco share and the option exercise price.

In August 1999, the parties entered into a Transaction Proposal Agreement, under which Imasco agreed to: (i) encourage option holders to exercise or surrender their options before the going-private transaction closing date; and (ii) accelerate the vesting of options under the stock options plan, such that all outstanding stock options would become exercisable prior to the completion of the transaction.

In January 2000, the transaction was approved, and all of the outstanding stock options issued under the stock options plan were exercised or surrendered for cash payments. The total amounts paid to the option holders was approximately $118,000,000. In computing its business income for that year, Imasco deducted this amount as employee compensation paid to satisfy its obligations under the employee stock option plan. The taxpayer argued that the payments were simply payments made by Imasco in the normal course of its business, and in the normal course of administering its employee stock option plan. However, the Minister took the position that the amounts are not deductible as they are not amounts paid as employee compensation, but rather amounts paid by Imasco in the course of the corporation reorganization to rid itself of an employee stock option plan. The Minister stated that such deduction was precluded by paragraph 18(1)(b) of the Act. The taxpayer appealed to the Tax Court of Canada.

The Tax Court dismissed the taxpayer's appeal. In its decision, the Tax Court referred to ***Kaiser Petroleum Ltd. v. The Queen,* 90 DTC 6603**, where the Federal Court of Appeal held that a payment made by the taxpayer to extinguish an employee share option plan was a payment on capital account. The Tax Court also referred to ***Shoppers Drug Mart Limited v. The Queen,* 2008 DTC 2043**, which was a case that arose out of the same going private transaction as the case at bar. However, the Tax

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Court in *Shoppers Drug Mart* was able to distinguish *Kaiser Petroleum* on the basis that it was the capital structure of Imasco, not that of Shoppers Drug Mart, that was reshaped.

The Tax Court stated that it could not distinguish *Kaiser Petroleum* from the case at bar, and instead was bound by the decision. Furthermore, the Tax Court stated that the question to be asked is "what was the expenditure calculated to effect from a practical and business point of view?" The Tax Court held that it was clear that the expenditure was calculated to give BAT some assurance that on completion of the going private transaction there would be no outstanding options remaining in the hands of Imasco employees. Moreover, if all Imasco intended was to settle up with its employees, then it need only have accelerated the vesting of unvested options, and employees could then have exercised them at will.

D. DAMAGES FOR LOSS OF STOCK OPTIONS

8. *Veer v. Dover Corp. (Canada) Ltd.* [1999] O.J. No. 1727

In this Ontario Court of Appeal case, Dover Corporation ("Dover") dismissed its senior executive ("Mr. Veer") when he continued to pursue the development of a joint venture contrary to Dover's wishes. When Mr. Veer brought an action for wrongful dismissal, Dover asserted that it had cause to terminate Mr. Veer, and specifically stated that there was persistent disobedience by Mr. Veer. At the trial court, the judge held that Mr. Veer had been dismissed by Dover without cause and was awarded damages equivalent to 24 months' notice together with damages for the loss of his stock options.

Dover appealed the decision, arguing among other things that (i) given the wording of the stock option agreement, Mr. Veer had no entitlement following his dismissal, and (ii) if Mr. Veer had a contractual entitlement, the damages should have been assessed as at the end of the notice period, not as of the date of judgment. The relevant provision in Mr. Veer's stock option agreement read as follows:

> *"If the option holder's employment with the corporation…is terminated for any reason other than [death, retirement, or incapacity], whether such termination be voluntary or involuntary…the option shall be cancelled…"*

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The Ontario Court of Appeal dismissed Dover's appeal and held as follows:

(i) the lack of a pattern of misconduct was a finding of fact that the trial judge was entitled to make;

(ii) while the stock option agreement includes both voluntary and involuntary termination as triggering events for the cancelling of Mr. Veer's stocks, absent clear language to the contrary, the agreement should not be presumed to have provided for the unlawful triggering events and thus, it cannot be concluded that the parties intended that an *unlawful termination* would trigger the end of Mr. Veer's option rights;

(iii) following his unlawful dismissal, Mr. Veer had 24 months of reasonable notice required for his termination to exercise the rights under the stock option agreements; and

(iv) the damages were correctly calculated as of the date of the judgment.

9. ***Gryba v. Moneta Porcupine Mines Ltd.*** **[2000] O.J. No. 4775**

In this Ontario Court of Appeal case, the employee ("Mr. Gryba") was dismissed from his position as president without cause and was awarded damages. The employer appealed on the basis that the trial judge did not apply the terms of the stock option plan. The relevant provision of the employee's stock option plan read as follows:

> *"If an optionee ceases to be employed by the Corporation otherwise than by reason of death or termination for cause, or if an optionee ceases to be a director other than by reason of death, removal or disqualification, any option of unexercised portion thereof held by such optionee at the effective date thereof may be exercised in whole or in part of a period of 30 days thereafter"*

Mr. Gryba did not exercise his stock options during the 30 days after his dismissal because he saw no financial benefit in doing so. The trial judge had concluded that Mr. Gryba was entitled to $62,400 for the loss of profit on his stock options, as the above provision from the stock option plan did not apply to determine his claim for damages. According to the trial judge, (i) an employee dismissed without notice is entitled to damages for the amounts he would have received from employment had he been given proper notice and allowed to work through his notice period, and (ii)

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if Mr. Gryba had been given proper notice, he would have had several months in which to exercise his stock options, not just the 30 days following his dismissal date.

The Ontario Court of Appeal dismissed the employer's appeal, and stated that while the terms of the stock option plan must govern, the question was whether the stock option plan clearly included as a triggering event a termination that was done in breach of contract. The Court of Appeal held that the wording of the stock option plan could be read as contemplating a lawful notice of termination and the effective date of the cessation of employment is the end of the notice period. Thus, Mr. Gryba was not required by the stock option plan to exercise his options within 30 days of his unlawful termination and was entitled to do so during his notice period.

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