Find the Right Fit
A Canadian ESPP Selection Guide

Solium
Market conditions make now the perfect time to launch or retool an ESPP

After being sidelined for a few years, employee share purchase plans (ESPPs) are getting a little more ice time these days. And with good reason. With an ESPP, employees make contributions to an account held for their benefit. From this account, shares of the company are purchased at regular intervals, either on the open market or from shares issued from treasury. Employees can make fractional share purchases, which are not permitted in individual brokerage accounts. These programs are also beneficial for employers. ESPPs can serve as both recruitment and retention tools, and function to align employee and shareholder values.

Given current conditions, now is a great time to either launch or retool your ESPP. In this white paper, we look at the six plan types in Canada – their advantages, disadvantages and unique characteristics – to help you discover which is right for your company.

Deferred profit-sharing plan

In a deferred profit-sharing plan (DPSP), the employer allocates a share of the profits to a trustee for the benefit of participating employees. Employees receiving a share of the profits paid out by the employer do not have to pay federal taxes on the money received from the DPSP until it is withdrawn. Deferred profit-sharing plans are quite similar to registered retirement savings plans (RRSPs) in that funds are taxed-deferred, but the major difference is that DPSPs do not allow for employee contributions.

Restrictions and vesting rules can be added to the plan structure, but the maximum vesting length is legislated and cannot exceed two years past the plan participation date.

Employee benefit plan

In an employee benefit plan (EBP), contributions are made by the employer for the employee and are subject to a vesting rule, typically no more than three years. Once the shares are vested, they are no longer considered to be part of the EBP and must be moved to an employee savings plan (ESP). For this reason, an EBP can’t function as a stand-alone plan.

Contributions are taxed on the vesting date using the market value on that date. Employees can expect taxes to be withheld on the pay period where the vest date falls.

An EBP can be a great fit for any company, but it’s often suited to bigger firms due to its administrative requirements. EBPs can present a lot of work for the payroll team at vesting time, as payroll must deduct taxes from employees’ pay. These plans also require the services of a trustee.
Employee profit-sharing plan

In an employee profit-sharing plan (EPSP), a company is able to share its profits with some or all of its employees. Employer contributions are most often calculated as percentage of the employee’s contribution, subject to the regulated minimum amount. Employer contributions are considered a taxable benefit and are added to an employee’s income in the year the benefit is received. EPSPs also allow employee contributions.

EPSPs allow for vesting, so they can be a great option for employers whose goals include retention. In fact, there is no vesting maximum, which offers employers a lot of flexibility. Yet it’s worth noting that a particularly long vest may not be popular with employees!

Employee savings plan

In an employee savings plan (ESP), contributions are deducted from employees’ pay and employers match the contributions according to defined parameters. Employer contributions are considered a taxable benefit and are added to an employee’s income in the year the benefit is received.

ESPs generally do not require the services of a trustee, and therefore are less costly to administer. For that reason, they can be great for small companies. A possible drawback of this plan type is that vesting is not permitted. Because employees receive the employer match right away, some argue that the ESP is a tool better suited to recruitment than retention. However, ESPs do permit restrictions. For instance, you might decide that the plan will not allow voluntary withdrawals for a given period.

Registered retirement savings plan

As most of us know, a registered retirement savings plan (RRSP) is a legal trust registered with the CRA used to save for retirement. RRSP contributions are tax deductible – employees participating through their employer contribute on a pre-tax basis and taxes are deferred until the money is withdrawn. The individual RRSP deduction limit is prescribed by CRA and is 18% of the prior year’s income to a maximum per year which is indexed for inflation. The maximum for 2014 is $24,270 and $24,930 in 2015. Individuals are responsible for monitoring their contribution limits.

Most Canadians are readily familiar with RRSPs and therefore may have less anxiety about participating. And RRSPs offer flexibility to employers because they enable restrictions. For instance, you might decide that the plan will not allow voluntary withdrawals for a given period. These plans require the services of a trustee, which will add administrative costs.
Tax-free savings account

Tax-free savings accounts (TFSAs) are a popular choice for ESPPs. They allow individuals to contribute up to $5,500 per year, and the contribution limit is indexed to inflation. Employer contributions count toward the yearly limit. Unused contribution room may be carried forward indefinitely. Any amounts withdrawn, including attributed gains or losses, will be also be factored into the individual’s contribution room. Most companies with a TFSA offer it as an add-on to another plan type, simply because the contribution limit is tough for employees to monitor. Payroll deductions to a TFSA are not practical, but transferring funds to a TFSA from a non-registered vehicle, such as an ESP or EPSP, is a good option. For that reason, TFSAs can’t truly function as a stand-alone ESPP.

In TFSAs, income and capital gains are not subject to income taxes, nor are losses deductible from capital gains outside the TFSA. Withdrawals, which are not subject to income tax, may be made at any time and for any reason, so TFSAs can offer more flexibility to employees than, for example, RRSPs.

Intelligent design

Selecting a plan type – or types – for your ESPP is just the beginning. There are a number of other considerations you need to take into account, including the employer match, compliance requirements, board approval, share registration, reporting requirements of the securities commission, as well as TSX and Canadian securities laws. Global companies headquartered in Canada will also want to consider in what way, if any, the ESPP will apply to global participants. Will employees in other countries be eligible? Will they receive similar benefits? Does your plan need to be registered in each country where you have employees?

There is a lot to think about. Solium has more than 10 years of experience with every type of ESPP in Canada. When you choose Solium to administer your ESPP, you gain access to deep industry expertise. We can help you design or – or redesign – a plan that works for you.
ESPPs at a glance

<table>
<thead>
<tr>
<th></th>
<th>DPSP</th>
<th>EBP</th>
<th>EPSP</th>
<th>ESP</th>
<th>RRSP</th>
<th>TFSA</th>
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</thead>
<tbody>
<tr>
<td><strong>Vesting</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Employee contributions permitted</strong></td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Employer contributions permitted</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Trustee required</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Tax deferred</strong></td>
<td>Yes</td>
<td>Yes – until vest.</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No, but investment gains are not subsequently taxed.</td>
</tr>
<tr>
<td><strong>Contribution limits</strong></td>
<td>CRA defined</td>
<td>No</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>CRA defined</td>
<td>CRA defined</td>
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<tr>
<td><strong>Plan registration</strong></td>
<td>Register with CRA</td>
<td>No requirement</td>
<td>Notify CRA</td>
<td>No requirement</td>
<td>Register with CRA</td>
<td>Register with CRA</td>
</tr>
<tr>
<td><strong>Tax implications for employees</strong></td>
<td>Employee contributions are not permitted. Employer contributions are not included in taxable income.</td>
<td>Employer contributions taxable to the employee at vest.</td>
<td>Employer contributions are taxable to the employee. Employee contributions are included in taxable income.</td>
<td>Employer contributions are taxable to the employee. Employee contributions are included in taxable income.</td>
<td>Employee and employer contributions not included in taxable income.</td>
<td>Employer contributions are taxable to the employee. Employee contributions are included in taxable income.</td>
</tr>
<tr>
<td><strong>Other employee tax events</strong></td>
<td>Employees pay tax upon withdrawal, based on value at time of withdrawal. Funds are taxed as regular income.</td>
<td>Dividends and interest earned are taxed as employment income.</td>
<td>Dividends and interest earned are taxed in the year earned. Realized gains and losses are taxed in the year of share sales per the CRA rules.</td>
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<td>Employees pay tax upon withdrawal, based on value at time of withdrawal. Funds are taxed as regular income.</td>
<td>None. Dividends and realized gains are not taxed at time of occurrence, nor are they taxed at withdrawal. Realized losses within the TFSA are not deductible from other capital gains.</td>
</tr>
</tbody>
</table>

To learn more, contact Solium at solutions@solium.com.

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