



GMS Flash Alert

Global Compensation Edition

2020-162 | June 4, 2021



Canada - CRA Issues "Hybrid Methodology" for Sourcing Cross-Border RSUs

In a recent technical interpretation ("TI"), the Canada Revenue Agency (CRA) provides details on a new "hybrid methodology" that it considers to be based in part on OECD guidance, used to determine the Canadian taxation of cross-border restricted share units (RSUs).¹ Generally, where an employee performs employment duties in Canada and a foreign jurisdiction, this hybrid methodology should be used to source the RSU benefits between these jurisdictions. As a result, taxpayers should use this methodology to determine taxable income earned in Canada, as well as foreign tax credit availability for Canadian residents.

WHY THIS MATTERS

It is important to be familiar with the new hybrid methodology and in some circumstances it may be beneficial depending on an individual's international employment history (e.g., a Canadian nonresident at settlement (payment) who has only been in Canada for a brief period of time after the year of grant).

The hybrid methodology will require additional tracking and taxpayers will need to gather additional information on work-days for the year the RSUs were granted (in addition to data on work-days from grant to vest date).

Then and Now

The CRA's position on sourcing cross-border employee stock option benefits has generally been to source the benefits according to the days of employment during the period between the grant of the option and when it is vested (the vesting period). This has been the CRA's position since 2012, when it changed its view to align with the OECD Model Tax Convention and extended the application of the OECD guidance to non-treaty countries. As RSUs and stock options are both forms of equity-based compensation that typically have a vesting period, this OECD guidance has historically been used for sourcing RSU benefits as well.

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The CRA notes that the OECD guidance on the taxation of cross-border stock options is used "in part" to inform its current views on the taxation of RSUs.

Different from previous guidance, the CRA's hybrid methodology separates the "in the money" ("ITM") portion of RSU benefits at the date of grant, i.e., the fair market value of the underlying shares at the date of grant, and notes that this portion generally relates to past services. The CRA also states that the new guidance applies to RSU benefits received after 2020, and advises that the guidance is subject to any relevant provisions in an income tax treaty between Canada and the foreign jurisdiction.

More Details

In this TI, the CRA advises that taxpayers should now use the hybrid methodology to source RSU benefits between Canada and a foreign jurisdiction.

The hybrid methodology requires taxpayers to split the RSU benefits into two parts – the ITM portion at the grant date and the fair market value (FMV) portion that accrues from the grant date to the vesting date.

In the CRA's view, the ITM portion of the RSU benefits generally pertains to past services and is sourced to the jurisdiction in which the employment services were rendered in the year the RSUs were granted. If employment services were rendered in multiple jurisdictions, the ITM portion of the benefits should be sourced to each jurisdiction in proportion to the employee's employment period in each jurisdiction that year. The FMV portion of the RSU benefits generally pertains to services rendered during the vesting period, and is sourced in proportion to the employee's employment period in each jurisdiction during the vesting period, according to OECD guidance.

KPMG NOTE

There are some potential inconsistencies within the CRA's view. For example, with this new TI, the CRA position contradicts its past guidance for sourcing cross-border RSUs. In addition, the CRA's position that the ITM component should be exclusively sourced to the jurisdiction of employment in the year of grant is also contradictory to a previous position, relating RSUs to past services.

Also, depending on what other taxing jurisdictions do, in terms of sourcing, there could end up being a mismatch of income sourcing and, thus, possible double taxation. Companies should consider their RSU grants and provide clarity regarding the services for which the grant is made, to potentially substantiate a future-based sourcing approach.

FOOTNOTE:

1 TI 2019-0832211I7.

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Contact us

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