Lexology Navigator
Executive Compensation & Benefits

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Tax-qualified or registered pension plans

Statutory framework

Is there a statutory framework governing the establishment and operation of tax-qualified or registered pension plans? If so, outline the general rules and requirements regarding:

(a) Vesting of benefits

Each jurisdiction in Canada has legislated vesting requirements. These generally provide that a plan member becomes entitled to a pension benefit from the plan (as opposed to a return of only his contributions with interest) upon meeting certain conditions. Once pension benefits are vested, they are usually locked in (eg, contributions made by and/or on behalf of a member must be used only to provide retirement income and can be withdrawn as a lump sum only in limited circumstances).

The time period for vesting varies across Canada, but most jurisdictions are moving to immediate vesting (ie, a member's entitlement vests immediately upon joining the plan). For example, federal, Ontario, Quebec and Manitoba provide for immediate vesting. Other jurisdictions, such as Newfoundland, New Brunswick and Saskatchewan, require vesting after two years of plan membership and/or continuous employment.

However, these vesting requirements often do not apply to include ancillary benefits (eg, benefits provided to members in addition to pension benefits such as early retirement or bridging benefits), which differ from pension benefits in that additional requirements must be met. For example, in order to be entitled to an early retirement benefit, plan members must often meet age and service requirements.

(b) Funding of plan liabilities

Pension standards legislation sets out detailed minimum funding requirements for defined benefit plans. (Funding requirements for defined contribution plans largely relate only to the timing of contributions, although for such plans to qualify under the Income Tax Act as a registered pension plan, employers must contribute a minimum of 1% of a member's earnings.)

At least every three years, defined benefit plan sponsors must perform an actuarial valuation of their plan. Most jurisdictions also require annual valuations where the plan's funded status has fallen below a prescribed level. An actuarial valuation determines the funded status of the plan on an ongoing and a solvency basis. In addition to current services costs, plan sponsors must make 'special payments' to amortise any going concern unfunded liability or solvency deficiency. Plan sponsors are generally required to amortise any going-concern unfunded liability over a maximum of 15 years and any solvency deficiency over a maximum of five years.

In response to recent funding difficulties faced by many defined benefit plan sponsors, several Canadian jurisdictions have passed temporary solvency funding relief provisions.

In addition, several jurisdictions have recently amended their legislation to permit plan sponsors to use letters of credit in lieu of cash contributions to partially fund solvency deficiencies.

(c) Tax consequences for employer and participants

In order to receive favourable tax treatment, a pension plan must be registered with the CRA and meet the requirements of the Income Tax Act. To encourage retirement savings, the Income Tax Act provides tax deductions (up to specified limits) to both employers and employees that make contributions under pension plans. For instance, employer and employee contributions are deductible from their respective income, subject to certain prescribed limits. The taxation of investment income and capital gains generated with the assets held in a pension fund is also deferred until the time of withdrawal or until benefits are paid. On the other hand, the Income Tax Act sets limits on the amount that may be contributed to and the level and type of benefits that may be paid from a registered pension plan.

Plans that are not in compliance with the Income Tax Act can be subject to penalties, including revocation of the registration of the plan, whereby the plan would lose its favourable tax treatment.

The CRA also limits the amount that registered pension plan members can contribute (overall) to tax-assisted retirement savings vehicles through the imposition of a pension adjustment. For example, the pension adjustment for defined contribution plans is 18% of earned income up to a maximum of C$ 25,370 in 2015. This is intended to ensure that all Canadian taxpayers at comparable income levels have access to comparable tax assistance (through sheltered savings), regardless of the type of plan in which they participate.

(d) Any requirement to hold plan assets in trust or in similar vehicles

Both the Income Tax Act and pension standards legislation prescribe the form in which pension assets must be held and who is permitted to hold such assets. Registered pension plans assets are most typically held through:

- insurance policies where the employer pays premiums to a life insurance company that undertakes to pay the pension benefits promised under the plan as they become due; or
- a trust which is governed by a trust agreement administered by a trust company or individual trustees.

Money payable under a pension plan is exempt from execution, seizure or attachment by other creditors of the employer. Certain jurisdictions, such as Ontario, also establish a statutory deemed trust with respect to contributions owing but not yet remitted to the pension fund.

(e) Any special fiduciary rules (including any prohibited transactions) regarding the investment of pension plan assets

The pension plan administrator and its agents (delegates) are subject to:

- statutory duties of prudence; and
- common law fiduciary duties when administering the plan and investing the fund.

The overriding obligation of every pension plan administrator is one of prudence. The administrator of a defined benefit plan is thus obliged, in its capacity as a fiduciary, to invest the assets of the plan in a prudent manner. In carrying out its duties in this regard, the administrator must exercise the care, diligence and skill that a person of ordinary prudence would exercise in dealing with property of another person and use all relevant knowledge and skill that it possesses or, by reason of the profession, business, or calling, ought to possess.

The administrator must also comply with the plan's investment policy and with certain specific restrictions on pension fund investments set out in the applicable pension legislation. Most jurisdictions in Canada have adopted the investment rules set out in the federal pension standards legislation or have substantially similar rules (the exceptions being New Brunswick, Nova Scotia and Quebec). These legislative restrictions include quantitative limits (eg, prohibition against holding securities to which are attached more than 30% of the votes that may be cast to elect the directors of the corporation; or to lend or invest more than 10% of the total market value of the plan's assets to any one person, associated persons or affiliated corporations) and prohibited transactions with certain related parties (eg, employer and affiliates, administrator).

These principles do not apply in the same way in the context of a member-directed defined contribution plan. In that context, the administrator's obligation as plan fiduciary is to provide a prudent menu of investment options from which plan members will choose in determining how to invest their DC accounts, and to provide members with sufficient information to make informed investment decisions. The plan administrator has no express obligation to ensure that each member account is diversified. However, the range of investment options which may be included in such menu will be subject to limitations under Canadian securities laws and, for some investment options, obligations to provide certain initial and ongoing annual disclosure to plan members. Discretionary exemptive relief from securities regulators in some jurisdictions may be required to extend certain investment options to employees resident in such jurisdictions.

There are no safe harbour provisions protecting employers from liability in relation to member directed plan investments in Canada. However, new federal legislation may provide a limited form of safe harbour for federally regulated defined contribution plans once it comes into force.

(f) Governmental oversight of plan administration and/or insurance coverage for plan benefits in the event of an employer's insolvency

Canadian pension regulators generally have the authority to appoint a third-party administrator to wind up a pension plan where the plan administrator fails to act, such as in case of insolvency. The only jurisdiction which provides a form of insurance coverage for pension benefits is Ontario. The Pension Benefits Guarantee Fund (PBGF), which is administered by the Ontario superintendent of financial services, guarantees the payment of pension benefits in respect of employment in Ontario up to specified maximums. Unlike the US Pension Benefits Guaranty Corporation, the PBGF does not take over the plan; instead, it offers some relief to members whose pensions are reduced on bankruptcy, provided that the PBGF itself has sufficient funds. Where money is paid out of the PBGF as a result of a plan wind-up, the superintendent has a lien and charge on the assets of the employer(s) that provided that plan.

Non-qualified pension & deferred compensation agreements

Unqualified pensions & deferred compensation

Do any special tax rules apply to these types of arrangement?

Employment income is generally taxed under the Income Tax Act upon receipt by the employee (ie, on a cash basis). There is an exception to this rule for amounts considered to be 'deferred amounts' under a salary deferral arrangement (SDA). Generally, an SDA is considered to be any arrangement under which anyone has the right in a taxation year to receive an amount after the year, where it is reasonable to consider that one of the main purposes for the creation or existence of the right is to postpone tax payable by the taxpayer in respect of salary or wages for services rendered by the taxpayer in the year or in a preceding year.

If an arrangement is an SDA, the deferred amount must be included in the employee's income in the current year (ie, the year in which the amount would have been included in the employee's income but for the deferral of its receipt), rather than in the subsequent year when the amount is actually received. Any notional interest or other amount credited or accrued to the end of each year on the deferred amount is added to the deferred amount and must therefore be included in the employee's income for the year in which the amount is credited or accrued. Several specific exceptions to the SDA rules are set out in the Income Tax Act, including exceptions for cash-based plans designed to pay out within three years.

Do these types of arrangement raise any special securities law issues?

Compensation arrangements which involve securities of an issuer are subject to various requirements under Canadian securities laws, including:

- a prohibition against trading in securities unless the person or company is appropriately registered to effect the trade (the 'registration requirement') or is exempt from such requirement; and
- a prohibition on distributing new securities unless they have been qualified by means of a prospectus (the 'prospectus requirement') or an exemption from that requirement applies. A 'distribution' is defined as a trade:
  - by an issuer in its own securities that have not been previously issued;
  - by or on behalf of the issuer in previously issued securities that have been redeemed, purchased or donated to the issuer; or
  - in the outstanding securities of the issuer from the holdings of a control block (eg, a holder of more than 20% of the outstanding securities of the issuer).

There are broad exemptions from the registration and prospectus requirements under Canadian securities laws with respect to trades in securities of an issuer to the employees of the issuer and its affiliates. However, these are not available where the arrangement involves some other type of security, such as an interest in a mutual fund or pooled investment fund. Discretionary exemptive relief from securities regulators in some Canadian jurisdictions may be required for arrangements involving such other types of securities.

Equity-based compensation arrangements

Treatment of grants

Outline the general tax, securities law and regulatory treatment relating to grants of:

(a) Stock options

The rules governing employee stock options are found in Section 7 of the Income Tax Act.

There are no tax consequences to the employee on grant of the option. Upon the acquisition of the shares upon exercising the option, the employee is deemed to have received a taxable employment benefit equal to the excess of the value of the shares at the time of their acquisition over the aggregate of the purchase price for the shares and any amount paid by the employee to acquire the option (the 'taxable benefit'). The taxable benefit is included in the employee's income from employment for the year, subject to an exception where the options are granted by a Canadian controlled private corporation (CCPC). In computing taxable income for the year in which the option is exercised, the employee may be eligible to be taxed on the taxable benefit at capital gains-type rates (ie, 50% of the rate applicable to ordinary income due to the deduction in Section 110(1)(d) of the Income Tax Act), if certain conditions are met. Generally, these conditions are as follows:

- The exercise price under the option was not less than the fair market value of the shares at the date the option was granted;
- Immediately after granting the option, the employee was dealing at arm's length with the corporation granting the options; and
- The share is a prescribed share (ie, a 'garden variety' common share with no limits, or maximum or minimum formulae for dividends or liquidation entitlements and with very limited put/call rights in respect of the shares) at the time of its issuance.

Where options are granted by a corporation that qualified as a CCPC at the time of the option grant and, immediately after the option is granted, the employee was dealing at arm's length with the corporation, the tax benefit realised on the exercise of such options is generally not included in the employee's income until the taxation year in which the shares acquired on the exercise are disposed of. Additionally, an employee can qualify for capital gains-type rates on the tax benefit realised on the exercise of CCPC options by holding the shares acquired on the exercise for two or more years as an alternative to meeting the requirements under Section 110(1)(d).

The grant of an option is a trade which is subject to the registration and prospectus requirements under Canadian securities laws. In addition to any other exemption which may be available, the grant will be exempt from such requirements pursuant to a special employee exemption, provided that:

- the Canadian residents who are granted the options are in an employment relationship at the time of grant with the issuer of the security or one of its affiliates; and
- the employee's participation in the plan is voluntary.

For this purpose, an 'affiliate' is an entity that controls or is controlled by the issuer of the security. A person is considered to control another person if it has, directly or indirectly, the power to direct management and policies of that person, by virtue of ownership of voting securities, a written agreement or being a general partner or trustee of that person. Further, participation will be voluntary if the participant is not induced to acquire the options or the underlying shares by expectation of appointment, employment or engagement, or continued appointment, employment or engagement, with the issuer or any of its affiliates. There are no reporting or disclosure obligations under Canadian securities laws with respect to the grant of options if the grant is made pursuant to such exemption.

Canadian stock exchange rules require stock exchange and shareholder approval for any security-based compensation arrangement of a listed issuer that may result in an original issuance of listed securities of the issuer, such as an option plan.

(b) Stock appreciation rights

A stock appreciation right (SAR) is a right given to an employee to receive a payment equal to the appreciation in value (if any) in the stock price from the grant date to a pre-determined payment date. A SAR may be granted as a standalone right or in tandem with an option such that an exercise of one cancels an equivalent portion of the other. Provided that the SAR has no value on the date of the grant (ie, its value is equal to the value of the underlying share), the grant of the SAR will have no tax consequences to the employee. Assuming that the SAR can be settled only in cash at a pre-determined date, the amount of the cash payment will be included in the employee's income from employment in the year of receipt. A SAR that has an exercise feature should generally be required to be exercised in the year of vesting to avoid the doctrine of constructive receipt.

If the SAR may be satisfied by original issuance securities, the grant will be subject to the registration and prospectus requirements and will need to comply with the requirements of an available exemption from such requirements, such as the employee exemption. Where the issuer is listed on a Canadian stock exchange, stock exchange and shareholder approval of the plan under which the grant is made are required. A SAR which can be settled only in cash should not trigger registration and prospectus requirements under Canadian securities laws or shareholder approval requirements under Canadian stock exchange rules.

(c) Restricted shares

On the issuance of a share, subject to trading restrictions, the employee will generally be treated as having acquired the shares and will be taxed on the fair market value of the share at the time of receipt. The tax authorities have historically accepted a reasonable discount from the fair market value of an unrestricted share in determining the fair market value of a restricted share. The fair market value of the restricted share will be included in the employee's income from employment in the year of receipt and will be taxed at ordinary rates. Upon any subsequent forfeiture, the employee will realise a capital loss equal to the employee's adjusted cost base of the share. Any such capital loss may be used only to offset realised capital gains in the year and cannot be used to offset the income inclusion arising in the year of receipt of the restricted share.

A grant of restricted shares is subject to the registration and prospectus requirements under Canadian securities laws and must comply with the requirements of an available exemption from such requirements, such as the employee exemption. Where the issuer is listed on a Canadian stock exchange, stock exchange and shareholder approval of the plan under which the grant is made are required.

(d) Restricted share units

A restricted share unit (RSU) is a proxy for a share in the capital of the company and generally entitles the holder to receive the value of the share at some later payment date. Upon the payment date, instead of receiving actual shares of the company, the employee will generally be entitled to be paid an amount in cash which is equivalent to the value of that number of shares on that date represented by the number of RSUs granted to the employee. Cash-settled RSUs are designed to fit within a specific exception to the SDA rules commonly referred to as the 'three-year rule' in order to ensure that the employees do not recognise a taxable benefit on grant of the RSU award. The three-year rule requires final payment to be made no later than December 31 of the third calendar year following the year of service to which the RSU award relates. Moreover, the three-year rule provides an exception to the SDA rules only in the context of a "bonus or similar payment" and cannot be relied on to defer salary.

Provided that a cash-settled RSU award fits within the three-year rule, the federal income tax consequences are as follows:

- There are no tax consequences on grant of the RSUs.
- The employment benefit is recognised when the employee receives a payment in respect of the RSU award and is equal to the fair market value of the amount received on pay-out.
- The employee is taxed on the full amount of the employment benefit.

If an RSU is forfeited prior to payment, there are no tax consequences to the employee.

Where RSUs are settled with original issuance shares, the taxation of these awards may be governed by Section 7 of the Income Tax Act and are generally taxed in the same manner as stock option awards; the SDA Rules do not apply and, accordingly, the three-year rule need not be satisfied. However, there is generally no ability to claim "capital gains" type treatment in connected with an award of RSUs.

Where RSUs are settled with original issuance securities, they will be subject to the registration and prospectus requirements under Canadian securities laws and will need to comply with the requirements of an available exemption from such requirements, such as the employee exemption. Where the issuer is listed on a Canadian stock exchange, stock exchange and shareholder approval of the plan under which the grant is made are required. RSUs which can be settled in cash only should not trigger the registration and prospectus requirements under Canadian securities laws or shareholder approval requirements under Canadian stock exchange rules.

(e) Phantom (ie, cash-settled) units

The term 'phantom units' is not defined in the Income Tax Act and is generally understood to refer to a cash incentive which is awarded based on the underlying stock value which generally serves as a proxy for equity compensation. RSUs, for example, are referred to as a form of phantom unit.

A deferred share unit plan is another form of phantom stock plan and is designed to fit within the exception provided in paragraph (l) of the SDA definition and Regulation 6801(d) of the Regulations to the Income Tax Act. The conditions which must be satisfied under Regulation 6801(d) are as follows:

- There must be an arrangement in writing between the corporation and the employee pursuant to which the employee may receive an amount that may reasonably be attributable to the employee's employment with the corporation.
- Payments are deferred until the employee retires, dies or otherwise terminates employment and payments are made no later than the end of the first calendar year commencing after that time.
- Amounts which may be received under the plan depend on the fair market value of the shares of the corporation at a time period that commences one year before the separation of employment and ends at the time the amount is received.
- No downside protection can be offered to the employee.

Phantom units which are settled in cash only should not trigger the registration and prospectus requirements under Canadian securities laws or shareholder approval requirements under Canadian stock exchange rules.

The pros and cons of granting different types of equity award from a general tax and regulatory standpoint are detailed in the attached table.

Payment of exec comp generally

Tax and regulatory limitations

Do any tax or regulatory limitations apply to amounts that may be paid to executives, or deducted by employers, with respect to executive compensation generally?

All cash payments are subject to the potential application of the SDA rules and the deductibility of amounts paid to employees or executives is governed by a reasonableness standard. No corporate-level deduction is available with respect to the issuance of any shares by the company to any of its employees.

Do any special limitations apply to severance benefits?

From an employment law perspective, there are no specific limitations. Canadian employment is not 'at will', so when an employer terminates an employee without cause, that employee must receive certain entitlements. These entitlements come from three sources:

- Contract – an employer and an employee can contractually stipulate what the employee receives on termination.
- Employment standards legislation – each province has in place an employment standards statute which sets out the minimum terms and conditions of employment that an employer must provide to an employee (eg, minimum wage, vacation, holidays, leaves of absence, overtime). Such legislation includes the minimum entitlement that an employee receives on termination. This entitlement varies from province to province, although in most it ranges from one to eight weeks of notice of termination or pay in lieu, depending on an employee's years of service. Ontario also has a statutory severance entitlement where an employee has five or more years of service and the employer has an annual Ontario payroll of C$2.5 million or more equal to approximately one week per year of service to a maximum of 26 weeks. (Note: In a recent Ontario case, the court included payroll outside of Ontario when calculating the C$2.5 million threshold.)

- Common law – Canadian courts have said that while it is important that the minimum is set out in employment standards legislation, an employee also has a common law right to notice of termination or pay in lieu. There is no formula to such entitlement; it is based on factors such as the employee's age, length of service, annual compensation and position. Using these factors to obtain case precedent, employees are awarded certain amounts by a court. A rough rule of thumb is about one month per year of service to a maximum of 24 months (though in a few recent cases, courts have exceeded the 24 month maximum). This includes the statutory minimums.

Do any special limitations apply to amounts payable under a change in control agreement?

No – not from an employment law perspective.

Special issues applicable to public companies

Regulatory disclosure

Does executive compensation raise any special regulatory disclosure issues?

Publicly traded issuers in Canada must provide disclosure respecting their compensation practices, including detailed disclosure of compensation awarded or earned by the issuer's chief executive officer (CEO), chief financial officer (CFO) and the three most highly compensated executive officers other than the CEO and the CFO (the 'named executive officers' (NEOs)). The disclosure must be made annually in the proxy circular sent to security holders in connection with any annual meeting, or any other meeting at which directors are to be elected or matters relating to compensation are to be approved. If the issuer is not required to send a proxy circular to its security holders, the disclosure must be included in the annual information form filed with Canadian securities regulators on the System for Electronic Document Analysis and Retrieval. Disclosure must include:

- a compensation discussion and analysis of factors relevant to the issuer's compensation decisions;
- numerical disclosure in tabular format of all amounts awarded or earned by each NEO and director;
- disclosure of director and officer indebtedness; and
- disclosure respecting securities authorised for issuance under equity-based compensation plans.

In addition, Canadian stock exchange rules require listed issuers to disclose annually in the proxy circular for the issuer's annual meeting, or other annual disclosure document distributed to all security holders, the material terms of each security-based compensation arrangement of the listed issuer that may result in an original issuance of listed securities of the issuer.

Compensation awarded to an issuer's executives and disclosure of such compensation are not subject to any binding or non-binding vote by the issuer's shareholders (say on pay) in Canada.

Employee transactions

Do any special rules apply to employee transactions involving employer securities?

Yes. Executives and certain other employees of publicly traded issuers are subject to a general prohibition against trading in securities of their employer while in possession of material information regarding their employer which has not yet been made public. These laws also prohibit such information from being passed on to others (including spouses, relatives or friends). Material information is information that, if disclosed:

- would reasonably be expected to have a significant influence on a reasonable investor's decisions to purchase, sell or otherwise trade in the employer's securities; or
- would reasonably be expected to have a significant effect on the market price or value of the employer's securities.

Canadian securities regulators have also taken action where equity-based compensation, including awards which could be settled only in cash, was granted at a time when the issuer was in possession of material information which had not yet been made public.

Certain senior executives of an issuer and of its material subsidiaries must file reports respecting their trading in securities and related financial instruments of the issuer. Individuals subject to such requirements include:

- the CEO, CFO and chief operating officer of the issuer and each major subsidiary of the issuer;
- any individual responsible for a principal business unit or function of the issuer;
- any individual who performs functions similar to any of the foregoing individuals; and
- any other insider who both:
  - has access to undisclosed material information; and
  - can exercise 'significant power or influence' over the business, operations, capital or development of the issuer.

Such reports must generally be filed within 10 days of becoming subject to the reporting obligation and within five days of any change in the information previously filed. Reports must disclose all securities of the issuer which are beneficially owned or over which the individual exercises control or direction. They must include:

- any derivatives or other related financial instruments;
- security-based compensation awards; and
- details of any other instrument, agreement or understanding that affects, directly or indirectly, a person's economic interest in a security of the issuer.

The rules of the Toronto Stock Exchange prohibit issuers listed on such exchange from granting stock options with an exercise price that is below the current market price of the shares.

Activist investors

Outline any general issues relating to the impact of proxy advisory firms such as ISS.

Proxy advisory firms have a significant influence on Canadian executive compensation practices, by making voting recommendations to their institutional shareholder clients regarding:

- votes on security-based compensation arrangements as required under Canadian stock exchange rules;
- withhold votes on the election of individual directors where the issuer's compensation practices are determined to be egregious; and
- say-on-pay votes for those Canadian issuers which voluntarily provide their security holders with an annual say-on-pay vote.

Their published views also influence compensation design by issuers wishing to adopt leading practices. The Canadian Coalition for Good Governance – a national institutional investor organisation established to promote good governance practices – also exerts influence by issuing reports on best practices and holding one-to-one meetings with directors of large Canadian issuers.

M&A issues

Pension plans treatment

Outline the treatment of pension plans in an M&A transaction. Do such transactions raise any special funding or regulatory issues (eg, required consents from governmental agencies or independent trustees)?

The treatment of pension plans in an M&A transaction will depend upon whether it is an asset transaction or a share (stock) transaction.

(a) Asset transaction

In an asset transaction, the parties usually deal with the pension plan in one of the following ways.

Future service only: The vendor remains responsible for all accrued liabilities under the vendor's pension plan for service up to the closing date. The purchaser establishes a new pension plan or allows transferring employees to join a pre-existing plan, and becomes responsible for the pension liabilities of the transferred employees from the closing date forward. Under this approach, an employee will receive two pension benefits upon retirement, which – in a final average earnings or best average earnings-type of defined benefit plan – together will be less than the employee would have received had he received one pension that took into account all years of service and future salary increases. In today's economic environment this approach is the most common, as it usually provides the purchaser with the most flexibility (eg, permitting a move from defined benefit to defined contribution), and is not complicated from a regulatory perspective – requiring the establishment of a new plan or, where a successor plan already exists, only the filing of plan amendments. Certain jurisdictions, such as Ontario, deem continuation of employment/service for purposes of determining eligibility/entitlement to benefits in the predecessor and successor plans.

Plan transfer: The entire plan is transferred to the purchaser and the purchaser assumes responsibility for pre and post-closing service of the transferred employees, as well as any retired employees or former employees who have vested entitlements. From a regulatory perspective, this type of approach is relatively straightforward, requiring only a plan amendment, approval of which is typically obtained after the fact.

Asset/liability transfer: Assets and liabilities in relation to the transferred employees' pensions are transferred from the vendor's pension plan to the purchaser's plan (either newly established or pre-existing). An asset/liability transfer is the most complex way of dealing with a pension plan in an asset transaction, particularly a defined benefit plan, as it requires not only the filing of plan amendments, but also plan valuation reports and notices to members and unions (if applicable). Further, unlike future service only or a plan transfer, regulatory approval must be obtained before completing the transfer. In Ontario, for example, this is a lengthy process which can take longer than a year to complete, although regulations were recently passed which are intended to clarify and expedite the process.

(b) Share transaction

In a share transaction, the pension plan transfers with the acquired company 'as is', unless the plan at issue is not a standalone plan (ie, plan membership includes employees of the target and its affiliates.) Where the plan at issue is not a standalone plan, employees will have to be 'carved out' of the shared plan. The parties will also have to decide whether accrued liabilities are to be assumed by the purchaser and, as such, the same options will apply, making it as complex as an asset transaction.

Equity compensation arrangements

Outline the treatment of equity compensation arrangements in an M&A transaction

Generally, in an M&A transaction, outstanding equity awards may be:

- exercised or surrendered for cash consideration prior to the consummation of the transaction;
- exchanged for comparable awards from the acquirer;
- remain unchanged and continue to exist after the transaction; or
- a combination of any of the foregoing.

The decision as to which of these options to choose will be affected by commercial, administrative and tax considerations associated with the particular transaction, including:

- whether the employees will continue to be employed following the transaction;
- whether outstanding equity awards are in the money or out of the money;
- whether post-transaction the existing equity awards will continue to be effective incentive tools; and
- the equity award arrangements of the acquirer.

Where an acquirer proposes to issue additional securities of a class listed on a Canadian stock exchange, for purposes of determining whether the number of securities to be issued pursuant to the acquisition exceeds 25% of the acquirer's outstanding securities, thereby subjecting the transaction to shareholder approval, the acquirer must include in the total securities to be issued pursuant to the transaction any that may be issued pursuant to the acquirer's agreement to honour the target's outstanding equity awards, whether by assuming those obligations or exchanging them for comparable awards from the acquirer.

Tax and regulatory issues

Does the treatment of executive compensation in an M&A context raise any special tax or other regulatory issues?

An M&A transaction can result in a variety of complex tax issues which must be considered in the context of executive compensation and both phantom equity and share-based awards. Certain plans may allow for accelerated vesting as a consequence of a transaction, allowing holders either to exercise options and participate in the acquisition transaction or alternatively to surrender options in exchange for a cash payment equal to the in-the-money amount. Ensuring that option holders remain entitled to claim the 50% deduction under Section 110(1)(d), and that other incentive award holders do not prematurely trigger tax liability without receiving any corresponding cash consideration to satisfy those tax liabilities, is important to both the holders and their potential new employers.

Where, as part of the transaction, the equity awards are exercised to acquire shares or surrendered for a cash payment, the employee will generally recognise a taxable employment benefit equal to the fair market value of the share or the amount of the cash payment, as applicable. Subject to certain exceptions applicable on the exercise of CCPC options, this employment benefit will be taxed in the year that the award is exercised or surrendered, and – provided certain requirements are met – the employee may still be entitled to the 50% deduction.

Where the transaction requires an equity award to be exchanged for a replacement award from the acquirer or the entity resulting from the transaction, it is possible in certain circumstances to structure the exchange so that it occurs on a tax-deferred basis. The availability of the tax deferral is particularly relevant where employees are exchanging in-the-money equity awards. The rules relating to exchanging in-the-money equity grants for other in-the-money equity grants are complex; but provided that the option holder's economic entitlement is not increased (ie, the in-the-money amount remains the same), and assuming certain other requirements are met, the exchange should be able to be structured to occur on a tax-deferred basis.

Acquirers and target entities making compensation-related cash payments in the context of M&A transactions will need to consider the deductibility of these payments.

Canadian securities laws relating to takeover bids prohibit the payment of collateral benefits which would result in certain selling security holders receiving a benefit that is not generally available to other selling security holders. For transactions subject to a vote by the target's shareholders, the payment of collateral benefits may result in the votes of those target security holders receiving the collateral benefit being excluded. Collateral benefits can include new or enhanced compensation arrangements agreed to be provided by the target or acquirer or another party, subject to certain exceptions.

Health insurance

Provision of insurance

Outline the extent to which health insurance coverage is provided by the government, through private insurers or through self-funded arrangements provided by employers.

In Canada, healthcare is largely administered and delivered by provincial governments. However, the Canada Health Act sets out certain criteria which must be met in order for provincial health programmes to be eligible for federal funding. Each province also funds a portion of healthcare expenses through general revenues or, in some cases, payroll taxes. Ontario additionally levies a health premium based on income level.

While levels of services can vary from one province to the next, generally, governments provide all Canadians, whether employed or not, with access to medically necessary services at clinics and hospitals. Elective services, such as semi-private or private hospital rooms, cosmetic surgery or drugs to be taken outside of a hospital, are not covered by government programmes.

There is no legal requirement in Canada for employers to provide private health and welfare benefits, whether fully funded by the employer or funded by the employer and the employee. However, employers often offer such benefits for competitive purposes. These usually include dental care, vision care, prescription drugs, medical supplies, and visits to other medical professionals (eg, chiropractors, registered massage therapists, psychologists).

Coverage levels

Do any special laws mandate minimum coverage levels that must be provided by an employer?

No. As stated above, an employer need not provide benefits. However, if an employer so chooses, the benefits must be provided to employees without human rights considerations (ie, different categories of employees cannot be treated differently if the categories have been established on prohibited grounds such as race, sex, family status or sexual orientation).

Can employers opt to provide different levels of health benefit coverage to different employees within the organisation?

Yes. An employer can provide different levels of benefits (or no benefits at all) to different categories of employee, provided that such distinctions are not based on discriminatory grounds as prohibited by human rights legislation. For example, benefits can be limited to full-time employees and excluded part-time employees. In addition, employers can provide 'flex plans' through a private health services provider, allowing employees to choose different levels of coverage.

Post-termination coverage

Are there any requirements that oblige employers to continue providing health insurance coverage after an employee's termination of employment?

Yes. In many provinces, continued benefit coverage is required for the minimum notice of termination period required under employment standards legislation (between one and eight weeks). If benefits are not provided during the common law notice of termination period, courts will also ascribe a damages amount to such benefits.

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