Employee Stock Option Plans: Key Considerations for Private Companies

Authors: Joel Olfert

published 05/23/2023

Stock option plans are an effective incentive and retention compensation method. Below is a list of key considerations for a private corporation developing a stock option plan.

Who is eligible to participate?

Stock option plans are often limited to employees at a management level, long-term employees, or key individuals.

When will the options vest?

Stock options vest when an employee can exercise the options that they have been granted. While options may vest immediately after being granted, most stock option plans have a vesting period of several years to encourage retention and continued growth. For example, a corporation may grant a certain number of options to an employee each year, but the options may only be exercised three years after being granted.

How is the strike/exercise price determined?

A strike price refers to the cost an employee must pay to exercise the options. The strike price is set when the options are granted. Most often, the strike price is consistent with the fair market value of the corporation at the time the options are granted. A corporation's fair market value is often determined by a third-party valuator or a predetermined formula.

How many options should be available?

A corporation should consider (a) the percentage of ownership it is willing to provide employees through options; and (b) the number of stock options which should be granted to employees to achieve the intended degree of compensation.

How will employment or ownership changes impact the options?

A stock option plan should clearly address changing circumstances, such as the sale of the corporation or an employee's retirement, termination, or death. In such situations, options may be automatically exercised, terminated, or expire after a period of time.

Are there tax implications associated with providing stock options to employees?

Canadian-Controlled Private Corporations offering options to employees do not receive any deductions for tax purposes and are not required to report to Canada Revenue Agency when options are granted. Rather, employees will account for the benefit after they have sold the shares of the exercised options.

Will the corporation's shareholder agreement need to be amended?

A shareholder agreement may not yet be designed or equipped to deal with employees becoming shareholders of the corporation. For example, if an employee exercises their options and would like to sell the shares back to the corporation, a well drafted shareholder agreement will provide a process for the employee to sell their shares. In many cases, the shareholder agreement will indicate that the purchase price is determined in the same way as the strike price is calculated. A shareholder agreement may also allow the corporation to pay the purchase price through quarterly installments rather than a potentially significant lump sum payment.

How is a stock option plan implemented?

A lawyer can assist in implementing a stock option plan. The lawyer will review existing corporate documents and prepare the appropriate approvals and share class, if necessary. Thereafter, the lawyer will help build a stock option plan to provide a process for how options are granted and exercised, as well as a stock option agreement form to be completed by each employee participating in the plan. The agreements typically include a form for employees to use when giving notice of exercising the options.

Author Joel Olfert's practice is focused on secured lending transactions, the acquisition and sale of business and commercial property, as well as corporate structuring, securities, and general corporate matters. **Please contact Joel** as you consider whether to implement a stock option plan.

---

guarantees regarding the accuracy or adequacy of the information contained herein or linked to via this article. The authors are not able to provide free legal advice. If you are seeking advice on specific matters, please contact Keith LaBossiere, CEO & Managing Partner at kdl@tdslaw.com, or 204.934.2587. Please be aware that any unsolicited information sent to the author(s) cannot be considered to be solicitor-client privileged.

While care is taken to ensure the accuracy for the purposes stated, before relying upon these articles, you should seek and be guided by legal advice based on your specific circumstances. We would be pleased to provide you with our assistance on any of the issues raised in these articles.