



Class Ruling

Income tax: HeartWare Group Restructure – Employee Share Scheme – treatment of options and performance rights

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- Division 13A of Part III (Division 13A) of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- section 130-83 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is all persons who prior to the restructure described in paragraphs 12 to 18 of this Ruling (the restructure), were employees of HeartWare Limited or any of its wholly owned subsidiaries (the HeartWare Group) who were granted rights to acquire HeartWare Limited shares under one of the employee share plans referred to in paragraph 11 of this Ruling. They are persons who, immediately prior to the restructure:

- held those rights (which are qualifying rights within the meaning of section 139CD);
- had not made an election under section 139E in relation to the rights; and
- had not had a cessation time (within the meaning of section 139CB) happen in relation to the rights; and

from the time of grant of the rights, to the time of the restructure:

- were residents of Australia (within the meaning of subsection 6(1)); and

immediately after the restructure:

- continued to be employed within the restructured HeartWare Group.

In this Ruling, a person belonging to this class of entities is referred to as a participant.

Qualifications

4. The Commissioner makes this ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 20 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies to the income year ended 30 June 2009. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description of the scheme:

- application for Class Ruling from PricewaterhouseCoopers (the applicant) dated 18 August 2008 including appendices;
- Information Memorandum dated 12 September 2008 including appendices;
- Federal Court of Australia Court Order dated 30 October 2008; and
- Publicly available information including Company Announcements and Australian Securities Exchange (ASX) Announcements.

10. Prior to the restructure, HeartWare Limited was a listed company on the ASX and was the head company of the HeartWare Group.

11. The HeartWare Group operated the following employee share plans (the plans):

- Employee Share Option Plan (unlisted options);
- Incentive Option Plan (standalone options); and
- Performance Rights Plan (performance rights),

which conferred on participants rights to acquire ordinary shares in HeartWare Limited. The above options and rights are collectively referred to as the old rights.

The restructure

12. The HeartWare Group undertook a corporate restructure on 11 November 2008 that resulted in the establishment of a new parent company. The new company, HeartWare International Inc was incorporated in the United States of America and is referred to in this Ruling as HeartWare US.

13. The restructure was implemented through three separate Federal Court of Australia sanctioned schemes of arrangement under the *Corporations Act 2001*:

- the share scheme for shareholders;
- the option scheme for unlisted option holders; and
- the performance rights scheme.

In conjunction with the schemes of arrangement, standalone option holders received offers to participate in a separate arrangement.

14. The applicant has advised that a key objective of the restructure was to place all current shareholders and rights holders in substantially the same financial position immediately after the restructure as they were immediately prior to the restructure.

Share scheme

15. Under this scheme of arrangement all of the existing ordinary shares in HeartWare Limited were transferred to HeartWare US. In consideration for shareholders transferring their shares, a shareholder received one CHESS Depository Interest (equivalent to an interest in one-thirty fifth of a share in common stock of HeartWare US). Shareholders had the option to elect to receive common stock in HeartWare US, in which case they would receive one share of common stock in HeartWare US for every 35 shares held in HeartWare Limited (subject to rounding).

Option scheme

16. Under this scheme of arrangement, all unlisted options were cancelled and participants who were unlisted option holders were issued with replacement options (new options) to acquire common stock in HeartWare US under an Employee Stock Option Plan adopted by HeartWare US. A participant received one new option for every 35 options held in HeartWare Limited (subject to rounding). Each new option issued to a participant:

- had an exercise price equal to 35 times the exercise price of the option it replaced;
- had an exercise period equal to the unexpired exercise period of the option it replaced;
- was vested to the same extent and had the same terms including the vesting schedules as the option it replaced; and
- otherwise issued under the terms of the new plan.

Performance rights

17. Under this scheme of arrangement, performance rights were cancelled and participants who were performance rights holders were issued with restricted stock units (RSUs) to acquire common stock in HeartWare US under a Restricted Stock Unit Plan adopted by HeartWare US. A participant received one RSU for every 35 performance rights held in HeartWare Limited (subject to rounding). Each RSU issued to a participant:

- had a nil exercise price as per the performance right it replaced;
- was vested to the same extent as, and had equivalent vesting conditions to, the performance right it replaced;
- was subject to the same performance hurdles (if any) as applying to the performance right it replaced; and
- otherwise issued under the terms of the new plan.

Separate arrangement for standalone options

18. In conjunction with the schemes of arrangement, standalone option holders received offers to have their standalone options cancelled, and were issued with replacement standalone options (new standalone options) to acquire common stock in HeartWare US. A participant received one new standalone option for every standalone option held in HeartWare Limited (subject to rounding). Each new standalone option issued to a participant:

- had an exercise price equal to 35 times the exercise price of the option it replaced;

- had an exercise period equal to the unexpired exercise period of the option it replaced;
- was vested to the same extent and had the same terms as to vesting as the option it replaced; and
- otherwise issued under the terms of standalone option deeds granted by HeartWare US to the standalone option holders.

The new options, new standalone options and RSUs are collectively referred to as new rights.

19. Immediately after the restructure, participants remained employees of either HeartWare US, HeartWare Limited or a subsidiary of HeartWare Limited.

20. The applicant has advised that at the time of issue of new rights to participants:

- no participant held a legal or beneficial interest in more than 5% of the shares in HeartWare US; or
- was in a position to cast or control the casting of more than 5% of the maximum number of votes that may be cast at a general meeting of HeartWare US.

Ruling

21. Where under the restructure, an old right acquired by a participant under one of the plans was replaced with a new right, the new right will be treated as a continuing right for the purposes of Division 13A.

22. Any capital gain or capital loss that arises under the restructure as a result of the replacement of an old right with a new right, will be disregarded, under subsection 130-83(1A) of the ITAA 1997.

Commissioner of Taxation

13 May 2009

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

23. The Commissioner accepts that where a participant was granted an old right they acquired a right under an employee share scheme for the purposes of section 139C.

24. Where a participant acquires a right under an employee share scheme the discount given in relation to the right is included in the assessable income of the participant.

25. Where a participant acquires a qualifying right and does not make an election under section 139E, the discount given in relation to the right is included in assessable income in the year of income in which the cessation time occurs in accordance with subsection 139B(3). This is subject to the operation of Subdivision DA of Division 13A in appropriate circumstances.

The restructure

26. The object of Subdivision DA is to allow Division 13A to continue to apply, in appropriate circumstances, to shares or rights acquired under an employee share scheme where a 100% takeover or restructure is involved.

27. In that regard section 139GCC defines the meaning of restructure for the purposes of this provision. A restructure of a company is a change in the ownership, or the structure of the ownership, of the company as a result of which some or all shares or rights held in the company under an employee share scheme immediately before the change are replaced, or could reasonably be regarded as having been replaced, wholly or partly by shares or rights in one or more other companies.

28. It is accepted that the restructure involved a change in the structure of the ownership of HeartWare Limited as a result of which some or all of the old rights held under the plans immediately before the restructure were replaced wholly or partly by new rights in HeartWare US. Therefore, the arrangement was a restructure within the meaning of section 139GCC.

29. Section 139DQ sets out in the first instance the circumstances that the provisions of Subdivision DA will apply to. In this case the relevant requirements are that:

- (a) an employee acquires a right in a new company;
- (b) the right can reasonably be regarded as matching a right in another company (the old company);
- (c) the right in the old company was acquired under an employee share scheme;

- (d) the acquisition of the right in the new company occurs in connection with a restructure of the old company; and
- (e) as a result of the restructure the employee ceased to hold rights in the old company.

30. For the purposes of subparagraph 29(a) of this Ruling, a participant, who held an old right in HeartWare Limited prior to the restructure, acquired a new right in HeartWare US (the new company) as a result of the restructure.

31. For the purposes of subparagraph 29(b) of this Ruling, in determining whether a right can reasonably be regarded as matching a right in another company, the note to subsection 139DQ(1) provides that one of the factors to consider is the respective market values of the old shares and the new shares. The Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004 (the EM) that introduced the provisions provides further guidance on this issue when it states at paragraph 3.14:

Matching shares or rights should be no more than that which is required to place the employee in the same position financially as if the restructure had not occurred.

Further, in paragraph 3.19 of the EM it states that:

The attributes of the shares or rights immediately before the restructure need to be the same, or substantially the same, immediately after the restructure.

32. The applicant has advised that a key objective of the restructure was to place all current shareholders and old rights holders in substantially the same financial position immediately after the restructure as they were immediately prior to the restructure. Further, having regard to paragraphs 16, 17 and 18 of this Ruling, the Commissioner accepts that the attributes of the new rights are substantially the same as the old rights they replaced.

33. Therefore, the Commissioner accepts that the new rights are regarded as matching the old rights in HeartWare Limited (the old company) which they replaced.

34. In accordance with paragraph 23 of this Ruling, the Commissioner accepts that where a participant was granted an old right they acquired a right under an employee share scheme for the purposes of section 139C. Therefore, it is accepted that the requirement in subparagraph 29(c) of this Ruling was satisfied.

35. For the purposes of the requirements in subparagraphs 29(d) and (e) of this Ruling, it is accepted that the acquisition by a participant of a new right in HeartWare US (the new company) occurred in connection with the restructure of HeartWare Limited (the old company). As a result of that restructure the participant ceased to hold an old right in HeartWare Limited (the old company) as the relevant right was cancelled when the restructure was implemented.

36. Having met the above requirements, section 139DQ also provides that the treatment of matching rights as a continuation of existing rights is also subject to the conditions in section 139DR.

Conditions for the continuation of rights

37. Section 139DR sets out the following conditions that must be met before the treatment of a new right as being a continuation of an old right in section 139DQ will have effect:

- (1) the employee must have held rights in the old company under an employee share scheme immediately before the restructure;
- (2) where the employee has not made an election under section 139E in relation to rights in the old company, the employee, at or about the time they acquired the matching rights must be employed by the new company, a holding company of the new company or a subsidiary of either the new company or a holding company of the new company;
- (3) the matching rights must be rights to acquire ordinary shares; and
- (4) at the time of acquiring the matching rights the employee must:
 - (a) not hold a legal or beneficial interest in more than 5% of the shares of the new company; and
 - (b) not be in a position to cast or control more than 5% of the votes at a general meeting of the new company.

38. An employee is considered to hold rights under an employee share scheme for the purposes of subsection 139DR(1), where:

- such rights were acquired under an employee share scheme;
- at the time of the restructure such rights are unexercised; and
- the rights are potentially subject to relief by the operation of section 139DD (no benefit where rights lost) if the rights lapse or are lost before being exercised.

39. In accordance with the class of entities (as described in paragraph 3 of this Ruling), participants are persons who were granted rights under one of the employee share plans and who held those (unexercised) rights at the time of the implementation of the restructure. Further, but for the restructure, if these were to lapse or be lost before being exercised, section 139DD can apply. Therefore, it is accepted that the first condition is met.

40. The applicant has advised that as part of the restructure a participant remained an employee of HeartWare US, HeartWare Limited or a subsidiary of HeartWare Limited. Therefore, it is accepted that the second condition was met.

41. The issue of new rights to participants entitled them to acquire shares of common stock in HeartWare US. The Commissioner accepts that a share of common stock in HeartWare US is an ordinary share for the purposes of Division 13A. Accordingly, the third condition was met.

42. In relation to the fourth condition, the applicant has advised that at the time new rights were acquired under the restructure, no participant held a legal or beneficial interest in more than 5% of the shares of HeartWare US or was in a position to cast or control the casting of, more than 5% of the maximum number of the votes that may be cast at a general meeting of HeartWare US. Therefore, it is accepted that this condition was met.

43. In summary, it is accepted that in relation to the restructure, the circumstances described in section 139DQ were present and the conditions set out in section 139DR were met. Therefore, new rights in HeartWare US issued to participants as a consequence of the restructure will be treated as continuing rights for the purposes of Division 13A.

Capital gains tax

44. Subsection 130-83(1A) of the ITAA 1997 provides that if a CGT event happens in relation to a right and it happens in connection with an acquisition of another right, that under section 139DQ of the ITAA 1936 is treated for the purposes of Division 13A as if it was a continuation of the original right, then any capital gain or capital loss from the CGT event is disregarded.

45. Where a participant held an old right to an HeartWare Limited share immediately before the restructure and, as a result of the restructure, acquired a new right in HeartWare US to replace the original right, then in accordance with paragraph 21 of this Ruling, the new (replacement) right will be treated as a continuing right for the purposes of Division 13A.

46. Therefore, where a CGT event happens in relation to an old right, in connection with the acquisition of a new right, any capital gain or capital loss made from the CGT event is disregarded.

Appendix 2 – Detailed contents list

47. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- employee share scheme
- options
- qualifying rights
- restructure

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B(3)
- ITAA 1936 139C
- ITAA 1936 139CB
- ITAA 1936 139CD
- ITAA 1936 139DD

- ITAA 1936 Pt III Div 13A Subdiv DA
- ITAA 1936 139DQ
- ITAA 1936 139DQ(1)
- ITAA 1936 139DR
- ITAA 1936 139DR(1)
- ITAA 1936 139E
- ITAA 1936 139GCC
- ITAA 1997 130-83
- ITAA 1997 130-83(1A)
- Copyright Act 1968
- Corporations Act 2001
- TAA 1953

Other references:

- Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004

ATO references

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