



Class Ruling

Income tax: Device Technologies Australia Pty Ltd adjustment to employee options

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❶ This publication provides you with the following level of protection:

This publication (excluding appendices) 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.

Summary – 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 provisions

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 104-10(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)
- subsection 104-25(1) of the ITAA 1997
- subsection 104-155(1) of the ITAA 1997
- subsection 104-155(2) of the ITAA 1997
- subsection 104-155(3) of the ITAA 1997
- subsection 116-20(2) of the ITAA 1997
- section 116-25 of the ITAA 1997

- section 995-1 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is all persons who are employees of Device Technologies Australia Pty Ltd (Device) who have acquired Options (either personally or through a nominee) under the Device Technologies Australia Pty Ltd Employee Share Option Plan (the Plan), and who:

- are residents of Australia within the meaning of section 6(1) of the ITAA 1936
- are not temporary residents as defined in subsection 995-1(1), and
- hold Options granted under the Plan immediately before the date of the proposed adjustments to the terms of the Options and will have the terms of their Options amended.

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

Qualifications

4. 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 8 to 22 of this Ruling.

5. 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.

Date of effect

6. This Ruling applies to the income year ended 30 June 2019. 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 *Public Rulings*).

Scheme

7. 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:

- class ruling application dated 8 August 2018 from Device Technologies Australia Pty Ltd, and
- Device Technologies Australia Pty Ltd Employee Share Option Plan (the Plan).

Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Device Technologies Australia Pty Ltd

8. Device is a privately held company incorporated in Australia and resident in Australia.

9. Device is primarily engaged in the distribution of medical equipment and consumables to hospitals and healthcare professionals in Australia and also engaged in operations in New Zealand, the United Kingdom and the United States.

10. Device currently has one class of share on issue, being ordinary shares (Shares). Each Share carries the right to vote at general meetings, the right to receive dividends and the right to participate in a return of capital.

11. The issued Shares in Device are currently held and controlled by three shareholders. Device's majority shareholder owns 98.5% of the Company's Shares.

Device Technologies Australia Pty Ltd Employee Share Option Plan

12. Device established the Plan in 2016 to provide key employees an opportunity to participate in the long-term growth of the company.

13. Device made one grant of Options to participants in October 2016 for nil consideration.

14. Under the terms of the Option grants made in October 2016, each Option granted:

- has an exercise price of \$146.06
- is subject to a performance vesting condition which requires Device to meet an EBITA target which is tested on 30 June for the four years following the year in which the Options are granted

- is subject to an employment related vesting condition (that is, the participant remaining employed with Device when the performance condition is satisfied)
- is subject to an exercise restriction which ends on the earlier of an Event occurring (as defined in Plan) or as determined by the Board but no later than six months before the date that is six years from the Grant Date
- once vested and Options are exercised, the participant is entitled to receive a share for each Option that is exercised. However, under the Plan, the Board may exercise its discretion to cancel or procure the acquisition of the Options for cash consideration (instead of a participant exercising his or her Options), and
- each option will expire on the sixth anniversary of the Grant Date if the Option remains unexercised.

15. The Options granted in October 2016 were considered to have nil value at the date of the grant under Division 83A of the *Income Tax Assessment Regulations 1997* as the exercise price of the Options was set at no less than 167% of the market value of a Share.

Special cash dividend

16. In February 2017, the board of Device approved and Device paid a special dividend of \$35.53 for each Share on issue, totalling \$46,856,796.

17. The special dividend resulted in a decrease of the total equity value of Device.

Adjustments

18. As a result of the reduction of total equity value of Device due to the special dividend, adjustments will be made to the Options.

19. The rules of the Plan allow the Board to adjust the terms of an option held by participants provided the amendment does not materially reduce the rights of any participant attaching to Options granted under the Plan prior to the amendment. Device intends to adjust the terms of the Options so as to ensure that participants do not enjoy a windfall gain nor suffer a material detriment as a result of the payment of the special dividend to shareholders.

20. Device will adjust the terms of the Options to decrease the exercise price by the amount of the special cash dividend paid on each Share on issue (that is, \$35.53).

21. The adjustment is intended to preserve the economic value of the Options.

Ruling

CGT event A1

22. The adjustment made to the Options will not result in the disposal of a CGT asset. Accordingly, the adjustment will not result in CGT event A1 happening (subsection 104-10(1)).

CGT event C2

23. The adjustment will not cause the ownership of an intangible CGT asset to end. Accordingly, the adjustment will not result in CGT event C2 happening to the Options (subsection 104-25(1)).

CGT event H2

24. CGT event H2 will happen when the adjustment is made to the terms of the Options as the adjustment is an act, transaction or event which occurs in relation to the Options and it does not result in an adjustment to their cost base or reduced cost base (subsections 104-155(1) and (2)).

25. No capital gain will be made in respect of the Options from CGT event H2 as there are no capital proceeds from the adjustment (subsection 104-155(3) and subsection 116-20(2), event H2) and the market value substitution rule does not apply (section 116-25).

Commissioner of Taxation

12 December 2018

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.*

26. The issue of when an agreement is varied or rescinded was considered by the High Court of Australia in *Tallerman & Co Pty Limited v. Nathan's Merchandise (Vic) Pty Limited* (1957) 98 CLR 93. Justice Taylor stated at page 144 that:

It is firmly established by a long line of cases... that the parties to an agreement may vary some of its terms by a subsequent agreement. They may, of course, rescind the earlier agreement altogether, and this may be done either expressly or by implication, but the determining factor must always be the intention of the parties as disclosed by the later agreement. Variation, of course, may involve partial rescission as is pointed out in *Salmond and Williams on Contracts* 2nd ed. (1945) pp. 488, 489, but 'Partial rescission... does not completely destroy the contractual relation between the parties. It merely modifies that relation by cutting out part of the rights and obligations involved therein, with or without the substitution of new rights and obligations in their place. Partial rescission is not the extinction of the contract but the variation of it...

27. The adjustment to the terms of the Options is intended to preserve the economic value of the Options by making an adjustment to the exercise price. The other terms of the Options remain the same. The adjustment is regarded as a variation of the Option terms that is permitted under the Plan. The adjustment does not cause the original option contract to end or result in a new option contract. Nor does the adjustment give rise to a disposal of the Option.

Appendix 2 – Detailed contents list

28. 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

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1997
- ITAA 1997 104-10(1)
- ITAA 1997 104-25(1)
- ITAA 1997 104-155(1)
- ITAA 1997 104-155(2)

- ITAA 1997 104-155(3)

- ITAA 1997 116-20(2)

- ITAA 1997 116-25

- ITAA 1997 995-1

- ITAA 1997 995-1(1)

- ITAR 1997

- ITAR 1997 Div 83A

- TAA 1953

Case references:

- Tallerman & Co Pty Limited v.
Nathan's Merchandise (Vic)
Pty Limited (1957) 98 CLR 93

ATO references

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ATOlaw topic: Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT
events C1 to C3 – end of a CGT asset
Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT
events H1 and H2 – special capital receipts

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