CR 2001/82 - Income Tax: Employee Share Scheme: Executive Option and Performance Right Plan Pacifica Group Ltd

Class Ruling
Income Tax: Employee Share Scheme: Executive Option and Performance Right Plan Pacifica Group Ltd

Contents Para

Preamble

The number, subject heading, and the ***What this Class Ruling is about*** *(including* ***Tax law(s)****,* ***Class of persons*** *and* ***Qualifications*** *sections),* ***Date of effect, Withdrawal, Arrangement*** *and* ***Ruling*** *parts of this document are a 'public ruling' in terms of Part IVAAA of the* ***Taxation Administration Act 1953****. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are sections:

- 139B of the *Income Tax Assessment Act* 1936 ('ITAA 1936');
- 139CB of the ITAA 1936;
- 139CC of the ITAA 1936;
- 139CD of the ITAA 1936;
- 139DD of the ITAA 1936;
- 139E of the ITAA 1936;
- 139FA of the ITAA 1936;
- 139FC of the ITAA 1936;
- 139FE of the ITAA 1936;
- 139FK of the ITAA 1936;
- 139FM of the ITAA 1936;

- 115-5 of the *Income Tax Assessment Act* 1997 ('ITAA 1997');
- 115-10 of the ITAA 1997;
- 115-15 of the ITAA 1997;
- 115-20 of the ITAA 1997;
- 115-25 of the ITAA 1997,
- 115-40 of the ITAA 1997;
- 130-80 of ITAA 1997;
- 130-83 of the ITAA 1997; and
- 134-1 of the ITAA 1997;

Class of persons

3. The class of persons to whom this Ruling applies is executive employees of Pacifica Group Limited (Pacifica) who acquire Options, being either zero exercise price options (Performance Rights) or market exercise price options (MEPOs), by participating in offers made under the Pacifica Executive Option and Performance Right Plan (the option plan). In this Ruling, this class of persons is referred to as the 'executives'.

Qualifications

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

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 11 to 16 is carried out in accordance with the details of the arrangement provided in this Ruling.

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

(a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled, and

(b) this Ruling may be withdrawn or modified.

7. A Class Ruling may only be reproduced in its entirety. Extracts may not be reproduced. Because each Class Ruling is subject to copyright, except for any use permitted under the *Copyright Act 1968* no Class Ruling may be reproduced by any process without prior

8. The Commissioner accepts that the Performance Rights and MEPOs acquired by the executives under the option plan are:

- rights acquired under an employee share scheme for the purposes of Division 13A of Part III of the ITAA 1936; and
- qualifying rights for the purposes of section 139CD of the ITAA 1936.

Date of effect

9. This Ruling applies to the years of income ended 30 June 2001, 30 June 2002 and 30 June 2003. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

10. This Ruling is withdrawn and ceases to have effect after the last day on which participating executive employees can have their returns of income lodged for the year of income ended 30 June 2003. The Ruling continues to apply, in respect of the tax laws ruled upon to all persons within the specified class who enter into a specified arrangement during the term of the Ruling. Thus the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to the withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of

and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- rules of the option plan; and
- submission received from Pacifica dated 16 February 2001.

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

12. The option plan commenced in the year ending 30 June 2001.

13. The option plan offered to executives has the following features:

(a) each option can be exercised to acquire one fully paid ordinary share in Pacifica;

(b) options are exercisable upon satisfaction of specific performance hurdles to be detailed by Directors in the invitation to executives;

(c) once the performance hurdles are satisfied, the options may be exercisable at any time during specified exercise periods in accordance with Pacifica's securities trading policy ('Exercise Windows') prior to the 10^{th} anniversary of the date of the grant;

(d) options do not confer rights to dividends;

(e) options will expire if not exercised within 10 years of the date of grant;

(f) in the event that an employee ceases employment (other than as set out in paragraph 13(g) below):

(i) the options held by the employee which have not become exercisable will lapse; and

(ii) options held by the employee which have become exercisable but have not yet been exercised will lapse if not exercised during the next Exercise Window; and

(g) in the event that an employee ceases employment by reason of death, total disablement or other circumstances deemed 'special' by the directors of Pacifica, the options will remain exercisable for such time as the directors may decide (subject to the maximum 10 year period).

14. The Plan operates on the basis that options will be either (**Performance Rights**) or (**MEPOs**). Although the directors of

Pacifica may approve loans by the company to an option holder in connection with the option and approve the transfer of the options acquired by an executive, it is not intended to offer such loans in respect of either the Performance Rights or the MEPOs. Ordinary shares in Pacifica are listed for quotation on the Australian Stock Exchange (**ASX**). However, neither the Performance Rights nor the MEPOs will be quoted.

Performance Rights

(a) Performance Rights will be issued to executives free of charge; and

(b) the exercise price will be nil.

MEPOs

(a) MEPOs will be issued to executives free of charge; and

(b) the exercise price will be the weighted average of the prices at which Pacifica shares are traded on the ASX during either the one week period up to and including the day of issue of the MEPOs, or the one week period up to, but not including, the day of issue of the MEPOs.

Ruling

Election to be taxed in the year of issue.

17. Where an executive makes an election under section 139E, the discount given in relation to each option is assessable to the executive under subsection 139B(2) in the year of income in which the right is acquired. As an executive does not provide any consideration for the acquisition of each qualifying right, the discount assessable is the market value of the option when it is acquired (subsection 139CC(2)).

18. For the purposes of sections 139FC and 139FE, the market value of each Performance Right at the time of its issue is the market value at that time of the ordinary share in Pacifica that could be acquired by exercising the Right. The market value of the ordinary share under section 139FA is:

- if there was at least one transaction on the ASX in those shares in the week up to and including the date of acquisition – the weighted average of the prices at the which those shares were traded on the ASX during that week; or

- if there were no such transaction in the period - the last price at which an offer was made on the ASX in that period to buy such a share or, if no such offer was made, the value of the share determined as if section 139FB applied to the share.

19. For the purposes of section 139FC, if the weighted average of the prices at which ordinary shares in Pacifica trade on the ASX in the one week period up to and including the day of issue is more than 97.5% but not more than 100% of the exercise price of a MEPO, the market value of each MEPO at the time of its issue is 18.4% of the exercise price.

20. If an executive chooses not to exercise an Option, the executive will lose the right to acquire a share. For the purposes of Division 13A, subsection 139DD(1) treats the option as if the executive had never acquired it and, therefore, there will be no amount on which the executive is assessable under the Division. If the executive has previously included an amount in his or her assessable income under Division 13A for a year of income, subsection 139DD(4) ensures that the executive's assessment for that year can be amended to exclude the amount previously assessed.

21. Where an executive acquires a share in Pacifica as a result of the exercise of an option, the share is not acquired under an employee share scheme for the purposes of Division 13A. If the executive sells a share so acquired within one year of exercise of the option, he or she will make a capital gain on the sale if the proceeds from the sale are more than the "market value" of the option at the date of issue. The sale of the share is a CGT event A1 (section 104-10 of the ITAA 1997). The cost base of the shares is the "market value" of the option on the day of issue of the option, plus the exercise price of the option in the case of a MEPO. If the share is sold within 12 months of exercise of the option, the capital gain cannot be a discount capital gain for the executive under Division 115 of the ITAA 1997.

22. However, where an executive disposes of a share 12 months or more after the exercise of the options, any capital gain that results from the disposal will be a discount capital gain. This is because the requirements of sections 115-10, 115-15, 115-20 and 115-25 of the ITAA1997 are met.

No Election to be taxed in the year of issue

23. Where an executive does not make an election under section 139E, the discount given in relation to each option is assessable to the executive under subsection 139B(3) in the year in which subsection 139CB(1) determines that the cessation time occurs.

24. Assuming that there are not any restrictions preventing an executive from disposing of the share acquired on the exercise of an option, or a condition that could result in the executive forfeiting ownership of the share, and the executive remains employed by the employer at the time of the exercise of the option, the cessation time for the option will be the time of the exercise of the option (paragraph 139CB(1)(d)).

25. If an executive acquired a share on exercising an option and sold the share within 30 days of exercise, the discount assessable under subsection 139B(3) will be the proceeds on the sale of the share less the exercise price of the option.

26. Accordingly, where an executive acquired a share on exercising an option and sold the share within 30 days of exercise, any capital gain arising from the sale is disregarded under subsection 130-83(2) of the ITAA 1997.

27. Where an executive, sells a share held for more than 30 days after the exercise of the option, the discount assessable under subsection 139B(3) is the difference between the market value of the share under subsection 139FA(1) when the option was exercised and the amount paid to exercise the option.

28. If an executive chooses not to exercise an option, the option is treated by subsection 139DD(1) as never having been acquired by the executive for the purposes of Division 13A.

29. Where an executive sells a share acquired on exercising an option more than 30 days, but within 12 months of exercise, he or she will make a capital gain on the sale, if the proceeds on sale are more than the market value of the share under subsection 139FA(1) when the option was exercised. Any capital gain cannot be a discount capital gain under Division 115 of the ITAA 1997.

30. However, if an executive disposes of a share 12 months or more after the exercise of the option, any capital gain that results from the disposal will be a discount capital gain. This is because the requirements of section 115-10, 115-15, 115-20 and 115-25 are met.

Explanations

Election to be taxed in the year of issue

31. An executive who acquires options is able to elect under subsection 139E(1) that subsection 139B(2) applies for a year of income in relation to each option acquired during the year, because the options are qualifying rights for the purpose of subsection 139CD.

32. Subsection 139E(2) requires that the election be made in writing, in a form approved by the Commissioner, before the executive lodges his or her return of income for the year of income, or within such further time as the Commissioner allows.

33. Subsection 139B(2) includes the discount given in relation to each qualifying right in the executive's assessable income for the year of income in which the right is acquired, not the year in which the right is exercised.

34. If a discount is assessable under subsection 139B(2), the discount is determined under subsection 139CC(2) as the market value of the option when it was acquired less any consideration paid by the executive to acquire it (being nil). The market value of an option on a particular day is then determined under Subdivision F of Division 13A (section 139F).

35. As the options are not quoted on an approved stock exchange, the market value of each option when acquired is determined under section 139FC as the greater of:

- the market value at the time of the ordinary share in Pacifica that may be acquired by exercising the option, less the lowest amount that must be paid to exercise the option (paragraph 139FC(1)(a)); or
- as the option cannot be exercised more than 10 years after it was acquired, and as the lowest price that must be paid to exercise the option is nil, the market value of the share at acquisition time (paragraph 139FC(1)(b) and section 139FE).

Market value of a Performance Right

36. Since the exercise price of a Performance Right will be nil, its market value under sections 139FC and 139FE will be the market value of the ordinary share in Pacifica on the day of issue of the Right. Since an ordinary share in Pacifica is listed on the ASX, its market value is determined by section 139FA to be as set out in paragraph 18 of this Ruling.

Market value of a MEPO

37. If the weighted average of the prices at which ordinary shares in Pacifica are traded on the ASX during the one week period up to and including the day of issue of the MEPO is more than 97.5% but not more than 100% of the exercise price of a MEPO, the application of paragraph 139FC(1)(a) to the MEPO produces a value that is nil (if paragraph 139FA(1)(a) applies to the ordinary share), and section

139FE does not affect the application of paragraph 139FC(1)(b). Accordingly, if paragraph 139FA(1)(a) applies to the ordinary share, the market value of a MEPO is determined by paragraph 139FC(1)(b) to be the value determined in accordance with sections 139FJ to 139FN.

38. Assuming that paragraph 139FA(1)(a) applies to the ordinary share, the calculation percentage for a MEPO determined under section 139FK will be more than 97.5% and not more than 100%. Then applying that calculation percentage according to the process set out in subsection 139FL(2) and section 139FM, the market value of the MEPO will be 18.4% of the exercise price of the MEPO (refer to Table 1, calculation percentage 97.5% to 100%, and exercise period 108 to 120 months in section 139FM).

39. If the weighted average of the prices at which ordinary shares in Pacifica are traded on the ASX during the one week period up to and including the day of issue of the MEPO is more than 100%, but no more 102.5% (assuming paragraph 139FA(1)(a) applies to the ordinary share), the market value of a MEPO will be the greater of:

(a) the difference between the weighted average of the prices at which ordinary shares in Pacifica are traded on the ASX during the one week period up to and including the day of issue of the MEPO and the exercise price (section 139FC(1)(a)); and

(b) the value determined by paragraph 139FC(1)(b) in accordance with sections 139FJ to 139FN. As the calculation percentage according to the process set out in subsection 139FL(2) and section 139FM is more than 100% but no more than 102.5%, the market value of the MEPO will be 20.0% of the exercise price (refer table 1, exercise period 108 to 120 months in section 139FM).

Options Not Exercised

40. Section 139DD treats a right to acquire a share in a company as never acquired by a taxpayer for the purposes of Division 13A if the taxpayer loses the right without having exercised it; and if the company employs the taxpayer or is a holding company of the taxpayer. If an executive does not exercise an option, the executive will lose the right to acquire an ordinary share in Pacific. Accordingly, the executive will be treated as if he or she had never acquired the option and, therefore, there will be no amount on which the executive is assessable under Division 13A.

41. If the executive has previously included an amount in his or her assessable income under Division 13A for a year of income,

subsection 139DD(4) ensures that the executive's assessment for that year can be amended to exclude the amount previously assessed.

Capital Gains Tax

42. CGT event A1 happens if an executive sells a share acquired as a result of exercising an option (section 104-10 of the ITAA 1997). The executive will make a capital gain if the proceeds from the sale are more than the cost base for the share. Item 1 of the table in section 134-1 of the ITAA 1997 indicates that the first element of the executive's cost base for the share is what the executive paid for the option plus any amount paid to exercise it. Note 3 to that table further indicates that the rule in Item 1 is modified by section 112-15 and Subdivision 130-D. This means that what the executive 'paid for the option' is its market value as determined under subsection 130-80(2), being the market value worked out under Subdivision F of Division 13A of the ITAA 1936 when the option was acquired.

43. If the share is sold within 12 months of exercise of the option, any capital gain resulting from the sale cannot be a discount capital gain because the requirements of section 115-25 ITAA 1997 are not met. CGT event A1 happens to the share within 12 months of the share being acquired on the exercise of the option.

44. If the share is sold 12 months or more after exercise of the option, any capital gain resulting from the sale will be a discount capital gain for the purposes of section 115-5 of the ITAA 1997. This is because the requirements of section 115-10, 115-15, 115-20 and 115-25 are met.

- Any capital gain would be made by an individual (section 115-10); and
- CGT event A1 would happen after 21 September 1999 (section 115-15; and
- CGT event A1 would happen at least 12 months after the share was acquired (115-25); and
- the cost base of the share would not be calculated by reference to indexation (section 115-20).
- This assumes that section 115-40 will not apply to prevent the capital gain from being a discount capital gain.

No Section 139E Election Lodged

45. If an executive does not make an election under subsection 139E(1) that subsection 139B(2) applies for a year of income, the

discount given in relation to each option is included by subsection 139B(3) in the executive's assessable income for the year in which subsection 139CB(1) determines that cessation time occurs.

Cessation Time

46. Subsection 139CB(1) provides that the 'cessation time' for an option is the earliest of:

(a) the time when the taxpayer disposes of the right (other than by exercising it);

(b) the time when the employment in respect of which the right was acquired ceases;

(c) if the right is exercised and there is a restriction preventing disposal of the share acquired or a condition that could result in the taxpayer forfeiting ownership of the share - the time when the last such restriction or condition ceases to have effect;

(d) if the right is exercised and there is no such condition or effect - the time when the right is exercised; and

(e) 10 years after the taxpayer acquired the right.

Options will lapse if not exercised within 10 years of issue. Accordingly, assuming that the circumstances in paragraph 139CB(1)(a), (b) and (c) do not apply, 139CB(1)(d) provides that the cessation time is the time of exercise of the option.

Discount

47. Subsection 139CC(3) provides that, if subsection 139B(3) applies to assess the discount given in relation to an option, and the share acquired on the exercise of the option is sold within 30 days of the cessation time, being the exercise of the option, the discount is the proceeds of sale less the amount paid to exercise the option.

48. Subsection 139CC(4) provides that, if subsection 139B(3) applies to assess the discount given in relation to an option, and the share acquired on the exercise of the option is not disposed of within 30 days after the cessation time, the discount is the market value of the shares at the cessation time, (i.e., time of exercise of the option) less the amount paid to exercise the option.

49. As an ordinary share in Pacifica is listed on the ASX, the market value of the share at the cessation time is determined under section 139FA according to the mechanism set out in paragraph 18 of this Ruling.

50. If an executive sells the shares, acquired by exercising an option, within 30 days of the cessation time, subsection 130-83(2) of the ITAA 1997 Act provides that any capital gain resulting from the sale is disregarded.

51. If the executive sells a share so acquired more that 30 days after the exercise of the option, the first element of the cost base of the share is its market value worked out under Subdivision F of Division 13A of the ITAA 1936 at the time of the exercise (subsection 130-83(3)). That market value is determined under section 139FA according to the mechanism set in paragraph 18 of this Ruling. The sale may give rise to a capital gain if the proceeds on sales are more than that market value.

52. If a share referred to in paragraph 50 above is sold within 12 months of the exercise of the option, any capital gain resulting from the sale cannot be a discount capital gain under Division 115 of the ITAA 1997 for the reason discussed in paragraph 43 of this Ruling. Similarly, if the share is sold 12 months or more after the exercise of the option, any capital gain resulting from the sale will be a discount capital gain for the purposes of section 115-5 for the reasons discussed in paragraph 44 of this Ruling.

Options Not Exercised

53. If an executive does not exercise an option, the executive will lose the right to acquire an ordinary share in Pacifica. As discussed in paragraph 40 of this Ruling, the executive will be treated by section 139DD as if he or she had never acquired the option and, therefore, there will be no amount on which the executive will be assessable under Division 13A.

Detailed contents list

54. Below is a detailed contents list for this Class Ruling:

Commissioner of Taxation
19 December 2001

Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

CR 2001/1; TR 92/1 TR 97/16; TR 92/20

Subject references:

- Employee Share Scheme and Options
- Election
- No Election
- Capital Gains Tax
- Cost Base
- Options not Exercised
- Options Exercised

Legislative references:

- ITAA 1936 139B
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139CB
- ITAA 1936 139CB(1)
- ITAA 1936 139CB(1)(a)
- ITAA 1936 139CB(1)(b)
- ITAA 1936 139CB(1)(c)
- ITAA 1936 139CB(1)(d)
- ITAA 1936 139CC
- ITAA 1936 139CC(2)
- ITAA 1936 139CC(3)
- ITAA 1936 139CD
- ITAA 1936 139DD
- ITAA 1936 139DD(1)
- ITAA 1936 139DD(4)
- ITAA 1936 139E
- ITAA 1936 139E(1)
- ITAA 1936 139E(2)
- ITAA 1936 139F
- ITAA 1936 139FA
- ITAA 1936 139FA(1)
- ITAA 1936 139FA(1)(a)
- ITAA 1936 139FB
- ITAA 1936 139FC

- ITAA 1936 139FC(1)(a)
- ITAA 1936 139FC(1)(b)
- ITAA 1936 139FE
- ITAA 1936 139FE
- ITAA 1936 139FJ
- ITAA 1936 139FL(2)
- ITAA 1936 139FK
- ITAA 1936 139FM
- ITAA 1936 139FN
- ITAA 1997 104-10
- ITAA 1997 115-5
- ITAA 1997 115-10
- ITAA 1997 115-15
- ITAA 1997 115-20
- ITAA 1997 115-25
- ITAA 1997 115-40
- ITAA 1997 130-80
- ITAA 1997 130-80(2)
- ITAA 1997 130-83
- ITAA 1997 130-83(2)
- ITAA 1997 130-83(3)
- ITAA 1997 134-1

ATO References
NO: T2001/019302
ISSN: 1445-2014