



# ***CR 2002/78 - Income Tax: WMC Limited Demerger - Option Scheme affecting employees and former employees of WMC Limited Group holding options over WMC Limited shares***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *4 December 2002*



## Class Ruling

### Income Tax: WMC Limited Demerger - Option Scheme affecting employees and former employees of WMC Limited Group holding options over WMC Limited shares

Contents	Para
What this Class Ruling is about	1
Date of effect	8
Withdrawal	9
Arrangement	10
Ruling	45
Explanations	68
Detailed contents list	108

#### *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.*

*[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

## **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:
- section 139B of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - sections 139C, 139CB, 139CC and 139CD of the ITAA 1936;
  - section 139DD of the ITAA 1936;
  - section 139E of the ITAA 1936;
  - sections 139FA, 139FB, 139FC, 139FJ, 139FK, 139FL, 139FM and 139FN of the ITAA 1936;
  - section 104-10 of the *Income Tax Assessment Act 1997* ('ITAA 1997');

- section 104-25 of the ITAA 1997;
- section 104-155 of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 130-80 of the ITAA 1997;
- section 130-83 of the ITAA 1997; and
- section 134-1(4) of the ITAA 1997.

## **Class of persons**

3. The class of persons to which this Ruling applies consists of Australian resident employees and former employees of WMC Limited and any of its subsidiaries (the WMC Group), who acquired WMC Limited (WMC) options under WMC employee share scheme Option Plans for the 1997 to 2002 income years inclusive. In this Ruling this class of persons is hereafter referred to as the Optionholders.

## **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 actually carried out is carried out in accordance with the arrangement described below at paragraphs 10 to 44 provided in this Ruling.

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

- (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.

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## **Date of effect**

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8. This Ruling applies from the date the proposed Demerger is effected pursuant to approvals obtained under the Corporations Act (see paragraph 36). 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## **Withdrawal**

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9. The Ruling is withdrawn from 30 June 2003.

## **Arrangement**

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10. 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:

- Letter from Arthur Robinson & Hedderwicks dated 4 September 2002;
- Letter from this Office to Arthur Robinson & Hedderwicks dated 21 August 2002;
- WMC Limited 2001 Option Plan;
- WMC Limited 2001 Option Plan Terms and Conditions; and
- Draft WMC Resources Limited Option Plan Terms and Conditions.

**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.**

## **WMC Option Plans**

11. The Terms and Conditions of the WMC employee share scheme Option Plans for the 1997 to 2002 income years inclusive, are substantially the same. Unless otherwise indicated, a reference to the Option Plan is taken to be a reference to each of these WMC Option Plans, and a reference to a particular clause is taken to be a reference to such a clause in the Terms and Conditions of each of these Option Plans.

12. The WMC Limited Options issued under the Option Plans (WMC Options) 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.

## **The Demerger**

13. The WMC Group comprises two principal components:

- the Alcoa World Alumina and Chemicals (AWAC) assets; and
- the non-AWAC assets.

14. WMC has announced a proposal to demerge these two principal components (the Demerger). The Demerger will involve a number of steps associated with a preliminary reconstruction, followed by the subsequent split of the WMC Group. Following the Demerger, WMC (to be renamed 'Alumina Limited') will continue to be listed on the ASX and remain the parent company of the companies operating the AWAC assets. WMC Resources Limited (WMCR) will cease to be a subsidiary of WMC and will become the parent company of the companies operating the non-AWAC assets. WMCR will apply to be admitted to the official list of the ASX.

15. WMC proposes to implement the Demerger:

- (a) pursuant to a scheme of arrangement under Part 5.1 of the Corporations Act between WMC and its shareholders; and
- (b) in such a way so as to take advantage of tax demerger relief legislation.

The Optionholders are employees and former employees of WMCR (or companies which will be subsidiaries of WMCR post-Demerger). Under each Option Plan, upon subscription employees were required to pay either 1 or 2 cents (depending on the year of issue) per WMC Option. The exercise price varies between respective issues as it is

based on the weighted average sale price of WMC shares on the day employees are invited to subscribe.

16. Clauses 5.5 and 5.6 of the Terms and Conditions provide:

*Subject to Clause 5.6, an Option is exercisable:*

- (a) *at any time after the expiry of one year from the Allotment Date (except that an Option may be exercised within one year from the Allotment Date by Employees who ceased to be employed by the Group as a result of death, retrenchment, retirement or, in any case determined by the Board in its discretion, sale or other transfer of any part of the business or assets of the Group) and on or before the expiry of five years after the Allotment Date; or*
- (b) *within six calendar months after any of the following events taking place...*
  - (v) *If a meeting of members of the Company approves a scheme of arrangement in accordance with the provisions of the Corporations Act.*

*Subject to Clause 5.7 an Option not exercised will lapse on the first to occur of:*

- (a) *the expiry of five years after the Allotment Date; and*
- (b) *the expiry of 30 days after the Employee ceases to be employed by the Group (except in the case of Employees who cease to be employed by the Group as a result of death, retrenchment, or retirement or, in any case determined by the Board in its discretion, sale or other transfer of any part of the business or assets of the Group in which case the Option will lapse, subject to paragraph (a), 2 years after such cessation of employment).*

17. The term *Group* is defined in Clause 1.1 to mean WMC and its subsidiaries.

### **Current Effect of the Demerger on Optionholder's right to acquire WMC shares**

18. There are three relevant categories of Optionholders:

- those who will continue to be employees of WMCR (being all current employees except a small number of employees who will be transferred to Alumina Limited (Alumina));

- the small number of employees who will be transferred to Alumina; and
- former employees of WMCR who hold WMC Options.

***Current employees***

19. Upon implementation of the Demerger (see paragraph 14), most employees of WMCR will continue to be employed by WMCR. However, the Demerger will cause WMCR to cease to be a subsidiary of WMC. As a result of the Demerger, those WMC Optionholders who are employed by WMCR immediately following Demerger will cease to be employed by the WMC Group for the purposes of the Option Plans. As a result, they will have 30 days to exercise their WMC Options (see paragraph 16 Clause 5.7(b)) at the reduced exercise price referred to at paragraph 26 below, before those WMC Options lapse in accordance with Clause 5.6(b).

***Alumina employees***

20. Any current WMCR employee who is subsequently employed by Alumina or its subsidiaries (the Alumina Group) upon implementation of the Demerger will remain entitled to exercise their WMC Options for the original exercise period of those WMC Options (as they will continue to be an employee of the 'Group') for so long as they remain employed by Alumina or one of its subsidiaries. (Exercise of the option will be at the reduced exercise price referred to in paragraph 26 below).

***Former Employees***

21. In accordance with Clause 5.6(b) (see paragraph 16), when an Optionholder ceases to be employed by the WMC Group, their Option will lapse 30 days after the cessation of employment unless the cessation of employment occurs because of death, retrenchment or retirement (or, in certain cases determined by the WMC Board, the sale or transfer of WMC Group assets). In the exception cases the WMC Options lapse 2 years after the cessation of employment. Optionholders who previously qualified for the 2 year extension under Clause 5.6(b) will continue to be entitled to exercise those WMC Options during that two year period (exercise of the option will be at the reduced exercise price referred to in paragraph 26 below), notwithstanding the implementation of the Demerger.

**The Demerger will reduce exercise price**

22. Clause 8.2 of the May 2000, 2001 and 2002 WMC Option Plans provides that:

*In the event of a reorganisation of the capital of the Company, the number of the Options or Exercise Price of the Options or both to which each holder is entitled will be changed to the extent necessary to comply with the Listing Rules applying to a reorganisation of capital at the time of the reorganisation.*

23. The 1997, 1998 and 1999 WMC Option Plans contain a Clause 8.2, which has the same substantive effect as Clause 8.2 in the 2000, 2001 and 2002 Option Plans.

24. ASX Listing Rule 7.22.3 prescribes the manner in which Options must be treated under a reorganisation. Where a reorganisation involves a return of capital, ASX Listing Rule 7.22.3 provides that:

*In a return of capital—the number of options must remain the same, and the exercise price of each option must be reduced by the same amount as the amount returned in relation to each ordinary security.*

25. ASX Listing Rule 7.22.3 is mandatory, and WMC is obliged to comply with its requirements when the Demerger is implemented (unless a waiver is granted).

26. The effect of the interaction of Clause 8.2 of the Option Plans and ASX Listing Rule 7.22.3 is that if the Demerger is approved, the exercise price of each WMC Option (irrespective of the Option Plan under which it was issued) will be reduced by the amount of the capital reduction involved in the Demerger. However, the exercise price will not be reduced by the amount of any dividend declared and payable in respect of each WMC Share as part of the Demerger.

27. Accordingly, under the Terms and Conditions of the current Option Plans the likely impact of the Demerger on the WMC Options is to reduce their value.

**The Option Scheme**

28. A scheme of arrangement under Part 5.1 of the Corporations Act between WMC and the Optionholders (the Option Scheme) is proposed, under which the following will occur:

- (a) the terms of the existing WMC Options will be amended to:
  - (i) reduce their exercise price in a manner that reflects the distribution of value in respect of each WMC share under the Demerger; and

- (ii) provide that they do not lapse as a result of Demerger; and
- (b) WMCR will grant Optionholders one WMCR Option, being an option to subscribe for a WMCR share, for each WMC Option they hold on the record date for determining entitlements under the Option Scheme (the Record Date).

***Amending existing WMC Option Plans***

29. The terms of the existing WMC Option Plans will be amended so that:

- the exercise price is reduced by an appropriate amount to reflect that the value of the shares to which the WMC Options relate is to be reduced by virtue of the capital reduction amount and the Demerger dividend amount; and
- the options do not lapse as a consequence of Demerger.

***Reduction in exercise price***

30. As set out above, the impact of the Demerger is that:

- the value of the WMC shares to which the WMC Options relate will decrease to reflect the market value of the WMCR Group (WMCR and its subsidiaries upon Demerger); however
- the exercise price of each WMC Option will only be reduced by the amount of the capital reduction involved in the Demerger.

31. To address the impact of the Demerger, the Terms and Conditions of the Option Plans will be amended to provide that the exercise price is reduced in proportion to the value distributed to shareholders in respect of each WMC Share under the Demerger.

32. The amended exercise price for the WMC Options will be determined by reference to their existing exercise price and the volume weighted average stockmarket price (VWAP) for WMCR Shares and Alumina Shares over the first five days of trading on the ASX in accordance with the following formulae:

$$\text{Amended WMC Option Exercise Price} = \text{Current WMC Option Exercise Price} \times \frac{\text{Alumina VWAP}}{(\text{Alumina VWAP} + \text{WMCR VWAP})}$$

33. For example, if the current exercise price of a WMC Option was \$9.35, and after the Demerger, the VWAP for WMCR Shares was \$4.00 and for Alumina Shares was \$6.00, then the adjusted exercise price for that WMC Option after the Demerger will be \$5.61 ( $=\$9.35 \times \$6.00/\$10.00$ ).

#### ***Options not to lapse***

34. The terms of the Option Plans will be amended to ensure that WMC Options do not lapse within 30 days of the Optionholder ceasing to be an employee of the WMC Group. This will be achieved by amending the Terms and Conditions of the Option Plans to provide that WMC Options will lapse within 30 days (or 2 years, as applicable) of the Optionholder ceasing to be an employee of the WMC Group or the WMCR Group.

35. This will ensure that the WMC Options will remain consistent with their original lapsing date (i.e., 5 years after issue for the majority of WMC Options), provided that post-Demerger the Optionholder remains employed by the WMCR Group or the Alumina Group (as the WMC Group will become post-Demerger).

#### ***Approvals required***

36. The changes to the Terms and Conditions of the Option Plans will take effect after the necessary approvals have been obtained from the Optionholders in accordance with Part 5.1 of the Corporations Act, the ASX under the Listing Rules and WMC shareholders.

#### ***The grant of WMCR Options***

37. In addition to amending the Terms and Conditions of the Option Plans, under the Option Scheme WMCR will grant each Optionholder one WMCR Option for each WMC Option they hold on the Record Date. Each WMCR Option will entitle the holder to subscribe for one WMCR Share.

38. The terms and conditions attaching to the WMCR Options will, to the extent practicable, mirror the Terms and Conditions of the Option Plans, but will incorporate such amendments necessary to reflect the varying exercise periods and exercise prices of the WMCR Options.

39. The two primary variants in the WMCR Options will be:

- the period during which the WMCR Options may be exercised; and
- their exercise price.

40. Immediately after the grant of the WMCR Options, no Optionholder will hold a legal or beneficial interest in more than 5% of WMCR, or be in a position to cast, or control the casting of, more than 5% of the votes that may be cast in a general meeting of WMCR.

***Exercise Period***

41. The exercise period of a WMCR Option will be the same as the exercise period of the WMC Option in respect of which the WMCR Option is granted. Further, a WMCR Option not exercised will lapse on the same date on which the WMC Option in respect of which the WMCR Option was granted lapses.

42. For example, if on the Record Date an Optionholder held 100 WMC Options which were due to expire on 21 December 2003 and 50 WMC Options which were due to expire on 20 December 2004, WMCR will grant that WMC Optionholder:

- 100 WMCR Options which expire on 21 December 2003; and
- 50 WMCR Options which expire on 20 December 2004.

***Exercise price***

43. The exercise price of a WMCR Option will be determined by reference to the exercise price of the WMC Option in respect of which the WMCR Option was granted and the VWAP for WMC Resources Shares and Alumina Shares over the first five days of trading on the ASX in accordance with the following formulae:

$$\text{WMCR Option Exercise Price} = \text{WMC Option Exercise Price} \times \frac{\text{WMCR VWAP}}{(\text{Alumina VWAP} + \text{WMCR VWAP})}$$

44. For example, if the exercise price of a WMC Option was \$9.35, and after the Demerger the VWAP for WMCR Shares was \$4.00 and for Alumina Shares was \$6.00, then the exercise price for the WMCR Option granted in respect of that WMC Option would be \$3.74 (= \$9.35 x \$4.00/\$10.00).

## **Ruling**

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### **WMC Options**

#### **Consequences for taxation of WMC Optionholders of certain events**

##### *Amendment of Terms and Conditions of the WMC Option Plans*

45. The amendment of the Terms and Conditions of the Option Plans in the income year of the Demerger, as described in paragraphs 10 to 44, will not result in an amount being included in the assessable income of a taxpayer holding unexpired WMC Options.

##### *Transfer of employment*

46. Where under the arrangements in preparation for Demerger, a taxpayer is employed by WMCR or an entity that will become a WMCR subsidiary on Demerger, holds unexpired WMC Options and is transferred in their employment to WMC or a subsidiary that will be part of the Alumina Group, that taxpayer will not be assessable on the discount given in relation to the acquisition of WMC Options solely as a consequence of their employment with WMCR, or its subsidiaries ceasing.

47. If a taxpayer employed by WMCR or a WMCR subsidiary who holds unexpired WMC Options and is transferred in their employment after the Demerger has been implemented to an entity within the Alumina Group, that taxpayer will be assessable on the discount given in relation to the acquisition of the WMC Options in the income year that the transfer occurs, providing no election is made under section 139E in relation to the options.

##### *The exit of WMCR from the WMC Group*

48. A taxpayer holding unexpired WMC Options at the time of the Demerger who continues to be employed by WMCR or a WMCR subsidiary after the Demerger will not be assessable on the discount given in relation to the acquisition of WMC Options as a consequence of WMC no longer being the holding company.

49. A taxpayer holding unexpired WMC Options at the time of the Demerger who transfers in their employment to WMC, or a WMC subsidiary that after the Demerger is part of the Alumina Group, will be assessable on the discount given with respect to the acquisition of the WMC Options in the income year of the Demerger providing no election is made under section 139E in relation to those options.

### *The exercise of the WMC Option*

50. For the purposes of the Capital Gains Tax provisions any capital gain or loss made from exercising a WMC option is to be disregarded.

51. A taxpayer who has not been assessed for income tax purposes on the discount given in relation to the acquisition of WMC options, will be assessable on the discount in the year the options are exercised.

### *Disposal of a share acquired by exercising a WMC Option*

52. Where a share is acquired by exercising a WMC Option by a taxpayer who made an election under section 139E in relation to the option, the first element of the cost base of that share is the market value of the WMC Option at the time it was acquired (calculated under section 139FC), and the amount paid to exercise the option.

53. Where a share acquired by exercising a WMC Option is disposed of in an arm's length transaction within 30 days of the cessation time (see section 139CA) by a taxpayer who did not make an election under section 139E in relation to the option:

- (a) the discount included in assessable income in the cessation year is the consideration received for the share less the exercise price of the option (subsection 139CC(3));
- (b) For the purposes of the Capital Gains Tax provisions any capital gain or loss made from the disposal of the share is to be disregarded.

54. Where a share acquired by exercising a WMC Option is not disposed of in an arm's length transaction within 30 days of the cessation time by a taxpayer who did not make an election under section 139E in relation to the option:

- (a) the discount included in assessable income in the cessation year is the market value of the shares at the cessation time calculated in accordance with Subdivision F of Division 13A less the exercise price of the options; (subsection 139CC(4))
- (b) the first element of the cost base of that share is the market value of the WMC option at the cessation time (calculated under section 139FC), and the amount paid to exercise the option.

***The ending of WMC Options through being allowed to expire.***

55. A taxpayer whose WMC Options expire without having been exercised will not derive assessable income as a consequence of the ending of the options.

56. A taxpayer who has been assessed on the discount given in respect of their acquisition of WMC Options will be entitled to an amendment of their income tax assessment (upon request) to adjust their assessable income for the year they were assessed if their WMC Options expire without having been exercised.

57. Where WMC options expire without having been exercised, CGT Event C2 (Section 104-25) will apply. Under section 104-25, a taxpayer will make a capital loss to the extent that they have incurred costs in relation to the acquisition of the options that form part of the cost base of the options. There will, however be no capital proceeds with respect to the ending of the options.

**WMCR Options**

58. A taxpayer who is granted WMCR Options under the Option Scheme will derive assessable income on the discount given in respect of these options.

59. The discount given to a taxpayer with respect to the acquisition of WMCR Options is included in the taxpayer's assessable income under section 139B of the ITAA 1936.

60. A taxpayer who is employed by an entity within the WMCR Group at the time WMCR Options are acquired may elect under section 139E to be assessed on the discount in the income year the WMCR Options are acquired.

61. A taxpayer employed by an entity within the WMCR Group at the time the WMCR Options are acquired who does not make an election under section 139E will be assessable on the discount in the income year in which the cessation time occurs. (Subsection 139B(3) and section 139CB).

62. A taxpayer who is employed by an entity within the Alumina Group at the time that WMCR Options are acquired, will be assessable on the discount in the income year the WMCR Options are acquired.

63. A taxpayer who, on acquisition of WMCR Options, is not employed by either Group, will be assessable on the discount in the income year the WMCR Options are acquired.

64. In circumstances where an amount is included in a taxpayer's assessable income, in the income year that the WMCR Options are acquired, the discount amount is the market value of the option at the

time acquired calculated in accordance with Subdivision F of Division 13A.

65. In circumstances where an amount is included in a taxpayer's assessable income in the income year of the cessation time for the WMCR Options and the WMCR Options or any shares acquired as a result of the exercise of the options are disposed of under an arm's length transaction within 30 days of the cessation time, the discount amount is the consideration received less the exercise price. (subsection 139CC(3)).

66. In circumstances where an amount is included in a taxpayer's assessable income in the income year of the cessation time for the WMCR Options and shares have been acquired as a result of the exercise of the options but are not disposed of under an arm's length transaction within 30 days of the cessation time, the discount amount is the market value of the shares at the cessation time calculated in accordance with Subdivision F of Division 13A less the exercise price of the options. (subsection 139CC(4)).

67. Where an amount is included in a taxpayer's assessable income in the income year of the cessation time for the WMCR Options, but the options have not been exercised in the circumstances outlined above in paragraphs 65 and 66 above, the discount amount is the market value of the WMCR option at the cessation time (calculated in accordance with Subdivision F of Division 13A); unless the option expires in the cessation year, in which case the discount will be nil.

## **Explanations**

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### **Issues with respect to holding of WMC Options**

#### ***Election under section 139E***

68. Taxpayers who have made an election to be assessed on the discount in the income year that the WMC Options are acquired may be concerned about the taxation implications of three matters arising with respect to the Demerger arrangements:

- the amendment of the Terms and Conditions of WMC Option Plans;
- the exercise of WMC Options that have an exercise price less than the value of the corresponding WMC shares that would be issued on exercise of such options ('in the money' options); and
- the expiry of WMC Options that have an exercise price greater than the value of the corresponding WMC

shares that would be issued on exercise of such options ('out of the money' options).

#### *Amendment of Terms and Conditions*

69. The amendment of the Terms and Conditions of the Options Plans is of relevance for Capital Gains Tax purposes only. The amendments will not result in a disposal (CGT event A1) or an ending (CGT Event C2). The amendments may be regarded as an 'act, transaction or event' in relation to a CGT asset and accordingly, CGT Event H2 applies (see section 104-155). However, this event will not affect a WMC Optionholder's tax position. There will be no capital gain or loss as there are no capital proceeds because of the event and no incidental costs to be incurred by WMC Optionholders that relate to the event.

#### *Exercise of 'in the money' options*

70. Any capital gain or loss on the exercise of an option by a taxpayer who has been assessed on the discount in the year that the option was acquired will be disregarded (see subsection 134-1(4)).

71. Where an option is exercised, the first element of the cost base of the share obtained is the amount paid to acquire the relevant option *plus* the exercise price of that option. (section 134-1). The combined effect of section 112-15 and subsection 130-80(2) is that an Optionholder who made an election under section 139E will be taken to have acquired the option for its market value at the time of acquisition, calculated under section 139FC. This cost base will be used to determine any capital gain or loss on the subsequent disposal of the relevant share.

#### *Lapse of 'out of the money' options*

72. Where, notwithstanding the reduction of the exercise price under the Demerger arrangements, an option is 'out of the money' it is likely that the holder will allow the option to lapse at the end of the exercise period. At that point, the right to acquire a WMC share is lost, without having been exercised. Under section 139DD, the taxpayer will be entitled to request an amended income tax assessment to obtain a credit or refund of tax paid on account of the discount being included in the taxpayer's assessable income in the year that the option was acquired.

73. The ending of an option on account of it expiring is a CGT Event C2. There will be no capital proceeds from the ending and the normal cost base rules under Part 3-1 will apply. The amount paid of 1

or 2 cents per option by the Option Holder when subscribing to the Option Plan forms part of the cost base.

### *No election under section 139E*

74. Where taxpayers have not made an election under section 139E with respect to their WMC Options they may be concerned about the taxation implications of a number of matters arising with respect the Demerger arrangements, including :

- amendment of the Terms and Conditions of the WMC Options Plans;
- transfer of employment;
- the fact that WMC will no longer be the holding company of WMCR and its subsidiaries;
- the exercise of ‘in the money’ options; and
- the expiry of ‘out of the money’ options.

75. Taxpayers who did not make an election under section 139E will be required to include the discount given with respect to the acquisition of the options in their assessable income if an event occurs triggering the ‘cessation time’ for the purposes of Division 13A. The ‘cessation time’ for a right to acquire a share is defined in section 139CB.

76. The consequences of cessation time occurring are dealt with at paragraphs 84 to 93 below.

### *Amendment of Terms and Conditions*

77. The amendment of the terms and conditions governing the right will not result in the cessation time occurring unless they are so substantial to be a disposal of the right (see paragraph 139CB(1)(a)). It is considered that the amendments contemplated under the Demerger arrangements are not of that order.

78. As explained in paragraph 69 above, the amendment of the Terms and Conditions of the Options Plans, although a CGT Event H2 under section 104-155, will not result in any capital gain or loss to WMC Optionholders.

### *Transfer of Employment and effect of change of status of WMC*

79. The cessation of the employment in respect of which the right was acquired is a cessation time event (paragraph 139CB(1)(b)). This is further explained in subsection 139CB(2). The effect is that an

Optionholder's employment for the purposes of section 139CB will not be considered to have ceased while they continue to be employed by an entity in the same group as the entity that was the employer at the time that the option was granted. A transfer of employment from one WMC entity to another, in preparation for the Demerger, will not of itself, result in the cessation time occurring. However, if an Optionholder has been transferred from an entity that is, or will be, in the WMCR Group upon Demerger, to WMC or an entity that is later part of the Alumina Group, the employment will cease for section 139CB purposes when the Demerger takes place. At that point WMC / Alumina will no longer be the holding company of the employer in respect of which the WMC Option was acquired.

80. A transfer of an Optionholder's employment from an entity in the WMCR Group to an entity in the Alumina Group after the Demerger has been implemented will also be a cessation time event under paragraph 139CB(1)(b).

81. Taxpayers who remain in employment with an entity in the WMCR Group under the Demerger arrangements, will not be subject to a paragraph 139CB(1)(b) cessation time event as a consequence of WMCR and its subsidiaries upon Demerger exiting the WMC Group.

#### *Exercise of 'in the money' options*

82. The exercise of a WMC Option will cause the cessation time to occur as there are no restrictions or conditions preventing the taxpayer from disposing of the WMC share(s) acquired as a result of the exercise (paragraph 139CB(1)(d) applies).

83. Any capital gain or loss made on the exercise of a WMC Option will be disregarded under subsection 134-1(4).

#### *Consequences of cessation time occurring—assessment of discount and capital gains*

84. For Optionholders not making a section 139E election, the discount given in relation to WMC Options is assessable in the year of income in which the cessation time occurs (the cessation year). The cessation time occurs at the earlier of when the relevant employment ceases or the option is exercised.

85. The discount to be included in assessable income for the cessation year will be calculated in accordance with subsection 139CC(3) or subsection 139CC(4) depending on whether a WMC share is acquired, and whether it is disposed of under an arm's length transaction within 30 days of the cessation time.

86. Where a WMC option is exercised, and the share acquired as a result is disposed of in an arm's length transaction within 30 days of the cessation time, under subsection 139CC(3) the discount included in assessable income is the proceeds of the disposal, less the amounts paid to acquire the option and to exercise the option.

87. For these Optionholders, any capital gain or loss made on the disposal of the share will be disregarded (see subsection 130-83(2)).

88. Under subsection 139CC(4), where the option is exercised at the cessation time but the relevant share acquired as a result is not disposed of in an arm's length transaction within 30 days of the cessation time, the discount amount is the market value of the share at the cessation time, less the amounts paid to acquire the option and to exercise the option.

89. As ordinary shares in WMC are listed on the ASX, the market value of the share at the cessation time is determined under section 139FA.

90. For these Optionholders, the cost base of a share acquired on the exercise of the option will be taken to be the total of the market value of the option at the cessation time (calculated under section 139FC) and the price paid to exercise the option (see section 134-1, section 112-15; and subsection 130-83(3)). Any subsequent sale of the share may give rise to a capital gain if the proceeds from such a sale exceed this cost base.

91. Where the option is not exercised in the circumstances of paragraphs 86 or 88 above, and does not lapse in the cessation year, the effect of subsection 139CC(4) is that the discount included in assessable income in the cessation year is the market value of the option at the cessation time, less the amount paid to acquire the option.

92. The market value of the option at the cessation time is calculated in accordance with section 139FC.

93. If such an Optionholder subsequently exercises a WMC option, the cost base of the share acquired as a result will still be taken to be the total of the market value of the option at the *cessation* time (calculated under section 139FC) and the price paid to exercise the option (see section 134-1, section 112-15; and subsection 130-83(3)). Any subsequent sale of the share may give rise to a capital gain if the proceeds from such a sale exceed this cost base.

#### *Lapse of 'out of the money' options*

94. WMC options that lapse will be subject to section 139DD. If taxpayers have been assessed on the discount given with respect to the acquisition of the option in the year of income that the cessation time

occurred, they will be entitled to request an amended income tax assessment to exclude this amount from their assessable income.

### **Issues with respect to the grant of the WMCR Options**

#### *Right to acquire a share*

95. WMCR Options are a 'call option' entitling the holder to be allotted a share in WMCR. They are a right to acquire a share for the purposes of Division 13A

#### *In respect of, or for or in relation directly or indirectly to any employment*

96. Under section 139C, the grant of rights must be in respect of any employment of the taxpayer for it to be subject to Division 13A. For this purpose it is relevant to ask whether the benefit granted is *a consequence* of any employment of the taxpayer in the sense of it being a *product or incident* of the employment. In answering this question it is relevant to enquire *how and why* the benefit was granted (refer to discussion of dicta from judgments in *Smith v. FC of T* (1987) 19 ATR 274 by Fisher J in *McArdle v. FC of T* 19 ATR 985 at 1000 – 1002; 88 ATC 4222 at 4235 – 4237). It may also be noted that while a mere historical connection with employment will not suffice (*FC of T v. Dixon* (1952) 86 CLR 402) a strict temporal relationship between the employment and the provision of the benefit is not required (*AAT Case 4338* 19 ATR 3496; *Case V76* 88 ATC 538)

97. While the number of WMCR Options that may be applied for by a WMC Optionholder is governed by the number of WMC Options held there are a number of considerations that tend to show that the relevant connection with employment exists:

- The grant of the new rights reflects a desire on the part of the entities involved to benefit certain employees of the WMC Group including former employees;
- The decision to offer new rights in the circumstances is apparently influenced by a desire on the part of the entities involved to keep faith with employees before and after the Demerger by acting to preserve the value of benefits provided under an employee share scheme, even for affected employees after they have ceased employment;
- The effect (an intended one) of the grant of the new rights is a restoration in full or part of value that employees and former employees stand to gain from benefits under an employee share scheme in the

absence of the Demerger; benefits that are clearly in respect of employment;

- There is nothing in the WMC Option rights that confers an entitlement or an expectation of a grant of the new rights;
- The grant of the new rights is not in any sense the product of the exploitation of rights possessed under the WMC Options;
- WMC Optionholders have not instigated the issue of the new rights; and
- Nothing is being surrendered by WMC Optionholders for the new rights.

*Was the acquisition under an 'employee share scheme'?*

98. The acquisition of the WMCR Options by taxpayers under the Option Scheme will be under an employee share scheme as defined in section 139C because the acquisition of the right is in respect of employment past or present with the WMC Group and no consideration is paid or given.

*Are the WMCR Options 'qualifying rights'?*

99. A right will be a qualifying right if the tests in section 139CD are satisfied. The second condition mentioned (subsection 139CD(3)) requires that the company (in this case, WMCR) be the employer of the taxpayer or a holding company of the employer of the taxpayer. This condition will only be satisfied in the case of recipients of WMCR Options who are, after the implementation of the Demerger, employed by WMCR or a WMCR subsidiary. The conditions of all other relevant tests are satisfied in relation to WMCR Options.

100. WMCR Options will therefore be qualifying rights, in the hands of WMCR Group employees only. Consequently, the deferral of taxation of the discount given with respect to the acquisition of WMCR Options by operation of subsection 139B(3) will only apply to WMCR Group employees.

101. Further, as the WMCR Options are qualifying rights in the hands of WMCR employees, they will have the right to elect, pursuant to section 139E, to be assessed on the discount given in the income year that the options are acquired.

102. Former employees of the WMC Group and employees of the Alumina Group at the time the WMCR Options are acquired by them

will be assessable on the discount given under subsection 139B(2), that is in the income year that the right is acquired.

*Calculation of the amount of the discount*

103. For taxpayers who are assessable or elect to be assessable on the discount in the income year that WMCR Options are acquired, the discount for each option will be the greater of the market value of a WMCR share at the time that the options were acquired less the exercise price of the option; and the value of the option determined under sections 139FJ to 139FN.

104. For taxpayers who are employees of the WMCR Group and do not make an election pursuant to section 139E, the discount with respect to each option is included in their assessable income in the cessation year, and is to be calculated in accordance with subsections 139CC(3) or subsection 139CC(4), depending on whether a share acquired by exercising the option is disposed of under an arm's length transaction within 30 days of the cessation time.

105. Where a share acquired on the exercise of the option is disposed of at arm's length within 30 days of the cessation time, the discount is the proceeds of disposal less the amount paid to exercise the option (subsection 139CC(3)). Any capital gain or loss on this disposal is disregarded (subsection 130-83(3)).

106. On the other hand, where a share is acquired on exercise of the option but is not disposed of at arm's length within 30 days of cessation time, the discount is the market value of the shares at the cessation time, less the amount paid to exercise the option (subsection 139CC(4)). If the option has not been exercised in this manner or as explained in paragraph 105 above, the discount is the market value of the option at the cessation time (subsection 139CC(4)), unless such an option lapses in the cessation year, where the discount will be nil.

107. In the circumstances attracting the operation of subsection 139CC(4), capital gains tax with respect to the disposal of a share acquired on exercise of the option, or other CGT events with respect to the option, will need to be considered by the taxpayer. For instance, a capital gain or capital loss arising from the disposal of a share acquired on exercise of the option (CGT event A1) would not be disregarded under the special rules in subdivision 130-D applying to employee share schemes.

## **Detailed contents list**

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

	<b>Paragraph</b>
<b>What this Class Ruling is about</b>	<b>1</b>
Tax law(s)	2
Class of persons	3
Qualifications	4
<b>Date of effect</b>	<b>8</b>
<b>Withdrawal</b>	<b>9</b>
<b>Arrangement</b>	<b>10</b>
WMC Option Plans	11
The Demerger	13
Current Effect of the Demerger on Optionholder's right to acquire WMC shares	18
<i>Current employees</i>	19
<i>Alumina employees</i>	20
<i>Former Employees</i>	21
The Demerger will reduce exercise price	22
The Option Scheme	28
<i>Amending existing WMC Option Plans</i>	29
<i>Reduction in exercise price</i>	30
<i>Options not to lapse</i>	34
<i>Approvals required</i>	36
<i>The grant of WMCR Options</i>	37
<i>Exercise Period</i>	41
<i>Exercise price</i>	43
<b>Ruling</b>	<b>45</b>
WMC Options	45
Consequences for taxation of WMC Optionholders of certain events	45
<i>Amendment of Terms and Conditions of the WMC Option Plans</i>	45
<i>Transfer of employment</i>	46
<i>The exit of WMCR from the WMC Group</i>	48
<i>The exercise of the WMC Option</i>	50
<i>Disposal of a share acquired by exercising a WMC Option</i>	52
<i>The ending of WMC Options through being allowed to expire.</i>	55

WMCR Options	58
<b>Explanations</b>	<b>68</b>
Issues with respect to holding of WMC Options	68
<i>Election under section 139E</i>	68
<i>Amendment of Terms and Conditions</i>	69
<i>Exercise of 'in the money' options</i>	70
<i>Lapse of 'out of the money' options</i>	72
<i>No election under section 139E</i>	74
<i>Amendment of Terms and Conditions</i>	77
<i>Transfer of Employment and effect of change of status of WMC</i>	79
<i>Exercise of 'in the money' options</i>	82
<i>Consequences of cessation time occurring—assessment of discount and capital gains</i>	84
<i>Lapse of 'out of the money' options</i>	94
Issues with respect to the grant of the WMCR Options	95
<i>Right to acquire a share</i>	95
<i>In respect of, or for or in relation directly or indirectly to any employment</i>	96
<i>Was the acquisition under an 'employee share scheme'?</i>	98
<i>Are the WMCR Options 'qualifying rights'?</i>	99
<i>Calculation of the amount of the discount</i>	103
<b>Detailed contents list</b>	<b>108</b>

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**Commissioner of Taxation**

6 November 2002

*Previous draft:*

Not previously released in draft form.

- Share Options
- Elections
- Expiry

*Related Rulings/Determinations:*CR2001/1; TR 92/1; TR 92/20;  
TR 97/16*Legislative references:*

- ITAA 1936 139B
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139C
- ITAA 1936 139CB
- ITAA 1936 139CB(1)(a)

*Subject references:*

- Employee Share Acquisition Scheme
- Demerger

# CR 2002/78

- ITAA 1936 139CB(1)(b)
  - ITAA 1936 139CB(1)(d)
  - ITAA 1936 139CB(2)
  - ITAA 1936 139CC
  - ITAA 1936 139CC(3)
  - ITAA 1936 139CC(4)
  - ITAA 1936 139CD
  - ITAA 1936 139CD(3)
  - ITAA 1936 139DD
  - ITAA 1936 139E
  - ITAA 1936 139FA
  - ITAA 1936 139FB
  - ITAA 1936 139FC
  - ITAA 1936 139FJ
  - ITAA 1936 139FK
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  - ITAA 1997 104-10
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  - ITAA 1997 130-83
  - ITAA 1997 130-83(2)
  - ITAA 1997 130-83(3)
  - Copyright Act 1968

*Case references:*

- Smith v FC of T (1987) 19 ATR 274
- McArdle v FC of T 19 ATR 985
- FC of T v Dixon (1952) 86 CLR 402
- Case 4338 19 ATR 3496;
- Case V76 88 ATC 538

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