

# ***CR 2003/100 - Income tax: Employee Share Scheme: Record Investments Limited***

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## Class Ruling

### Income tax: Employee Share Scheme: Record Investments Limited

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#### ***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**, **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

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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:
- Section 139B of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - Section 139BA (ITAA 1936);
  - Section 139C (ITAA 1936);
  - Section 139CA (ITAA 1936);
  - Section 139CC (ITAA 1936);
  - Section 139CD (ITAA 1936);
  - Section 139CE (ITAA 1936);
  - Section 139E (ITAA 1936);
  - Section 139FA (ITAA 1936);
  - Section 139FB (ITAA 1936);
  - Section 139G (ITAA 1936);

- Section 104-75 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 109-5 (ITAA 1997);
- Section 130-80 (ITAA 1997); and
- Section 130-83 (ITAA 1997).

## **Class of persons**

3. The class of persons to which this Ruling applies are all Australian resident employees of Record Investments Limited ('Record Investments') who acquired shares in Record Investments under the Record Investments Share Allocation Plan (RISAP) described in the Arrangement part of this Ruling. This class of persons is referred to as the 'participating employees'.

## **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 is carried out in accordance with the arrangement described below at paragraphs 9 to 22 in this Ruling.

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

- 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
- this Ruling may be withdrawn or modified.

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## **Date of effect**

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8. This Ruling applies from the 2002-2003 year of income. 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 the Ruling (see paragraphs 21 and 22 of taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the Gazette;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

## **Arrangement**

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9. The arrangement that is the subject of this 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:

- Class Ruling Application, dated 9 May 2003;
- Record Investments Share Allocation Plan Rules [RISAP Rules] dated 7 November 2002; and
- Trust Deed in respect of the trustee of the Record Investments Share Allocation Plan [the Trust Deed] made between Record Investments Limited (ABN 53 077 721 129), the Company, and RIL Finance Pty Ltd (46 095 162 833), the Trustee, dated 7 November 2002.

10. Record Investments was initially registered on 27 March 1997 as a Pooled Development Fund (PDF), pursuant to the *Pooled Development Fund Act 1992* (although the company is no longer registered as a PDF). Between 27 March 1997 and the date on which Record Investments was listed on the Australian Stock Exchange ('ASX'), Record Investments did not carry on any active business.

11. Record Investments floated on the ASX on 28 February 2001. At that time Record Investments commenced active business, and consequently became an employer company. Record Investments currently has 6 employees and 5 non-executive directors.

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12. Record Investments has established a special purpose company, RIL Finance Pty Limited (hereafter, referred to as the 'trustee company'). The trustee company acts as trustee in the implementation and administration of the RISAP.
13. Under the terms of RISAP, ordinary shares in Record Investments are offered by way of an invitation to participate in the RISAP being made to selected Australian employees of Record Investments.
14. The trustee of RISAP has used funds it has received from Record Investments to acquire shares in Record Investments on market. The Record Investments shares were acquired by the trustee for the shares' market value at the time of acquisition.
15. Through the RISAP, Record Investments has made an offer to acquire ordinary shares in Record Investments to its employees.
16. Pursuant to that offer, Record Investments shares acquired by the trustee of RISAP have been allocated to an employee of Record Investments (hereafter referred to as 'the participating employee'). For the purposes of Division 13A of the *Income Tax Assessment Act 1936*, the participating employee acquired the Record Investments shares at that time.
17. The Record Investments shares allocated to the participating employee are being held by the trustee of RISAP for the benefit of the participating employee.
18. Disposal restrictions have been imposed in respect of the participating employee's interest in the Record Investments shares acquired under the RISAP. The disposal restrictions restrict the ability of the participating employee to dispose of certain shares (but not all) of Record Investments shares acquired by the participation employee under the RISAP.
19. The Record Investments shares acquired by the participating employee under the RISAP are also subject to forfeiture in the event of certain circumstances (such as fraud on the part of the participating employee).
20. The Record Investments shares allocated to the participating employee will vest in three separate tranches, provided that the participating employee has satisfied the vesting period and certain performance criteria.
21. At the time a particular tranche of Record Investments shares vests, and there is no disposal restriction attaching to those shares, the participating employee becomes absolutely entitled to the shares in the relevant tranche.

22. The conditions applicable to the acquisition of the shares in Record Investments by the trustee of RISAP on behalf of the participating employee are set out in the RISAP Rules. The RISAP Rules govern the respective relationship between Record Investments, the participating employees and the trustee company.

## **Ruling**

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### **Where the participating employee does not make an election under section 139E**

23. Where a participating employee acquires shares under the RISAP and does not make an election under section 139E, the amount of discount on the shares will be included in assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

24. As there are restrictions and forfeiture conditions on the shares acquired under the RISAP, the cessation time is determined under subsection 139CA(2).

25. Where the participating employee subsequently disposes of the shares in an arm's length transaction within 30 days of the cessation time, the discount included in assessable income at the cessation time under subsection 139B(3) is calculated in accordance with subsection 139CC(3). The discount is the consideration received by the participating employee for the disposal of the shares.

26. Any capital gain or loss made as a consequence of such a disposal is disregarded pursuant to subsection 130-83(2) of the Income Tax Assessment Act 1997 (ITAA 1997).

27. Where the participating employee does not subsequently dispose of the shares in an arm's length transaction within 30 days of the cessation time, the discount included in assessable income at the cessation time under subsection 139B(3) is calculated in accordance with subsection 139CC(4). The discount is the market value of the shares at cessation time. The market value of the share is worked out under section 139FA.

28. The first element of the cost base of such shares upon a capital gains tax (CGT) event happening is their market value at the cessation time pursuant to subsection 130-83(3) of the ITAA 1997.

29. Where an employee acquires shares under the RISAP and does not make an election under section 139E in respect thereof, and the shares are subsequently forfeited under the RISAP Rules, no amount is included in assessable income under subsection 139B(3) and there are no CGT consequences.

**Where a participating employee makes an election under section 139E**

30. Where a participating employee acquires shares under the RISAP and makes an election under section 139E, the discount on the shares is included in the employee's assessable income in the year of income in which the shares are acquired pursuant to subsection 139B(2). This will be the year of income in which the trustee allocates the shares to the participating employee.

31. The discount will be calculated in accordance with subsection 139CC(2). The amount of discount to be included in the participating employee's assessable income is the market value of each share at the time that it was allocated to the participating employee by the trustee. The market value of a share at this time is determined under section 139FA.

32. As the RISAP Rules do not satisfy the exemption conditions in section 139CE, subsection 139BA(2) does not apply to reduce the discount included in assessable income by up to \$1,000.

33. The first element of the cost base of the shares for the purposes of the capital gains tax provisions is determined in accordance with section 130-80 of the ITAA 1997.

34. Where a participating employee acquires shares under the RISAP, makes an election under section 139E and the shares are subsequently forfeited under the RISAP Rules, the amount of discount on the shares is included in assessable income under subsection 139B(2) as outlined above in paragraphs 30 and 31.

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**Explanation**

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**Employee share schemes**

35. Section 139G provides that a person acquires a share in several circumstances, including by acquiring a beneficial interest in the share, or having a share allotted to them by another person.

36. For the purpose of Division 13A, the participating employee will have acquired a share when the trustee sets aside and holds shares for his or her benefit.

37. For Division 13A to apply, the beneficial interest in the share must be acquired under an employee share scheme. Subsection 139C(1) provides that a share is acquired under an employee share scheme if the share is acquired in respect of, or in relation directly or indirectly to, any employment of the taxpayer (that is, of the participating employee).

38. Subsection 139C(3) provides that a share is not acquired under an employee share scheme unless it is acquired for less than its market value. The condition is satisfied under the RISAP as the participating employee is not required to make any payment for the allocation of shares.

39. A participating employee will therefore acquire shares under an employee share scheme within the meaning given by section 139C, as the shares will be acquired by that employee for less than market value and in respect of, or in relation to, their employment.

40. The discount given in relation to the acquisition is included in assessable income in accordance with section 139B. It is included in the income year in which the share is acquired where an election under section 139E is made by the participating employee (subsection 139B(2)) or, where no such election is made, in the income year in which the cessation time occurs (subsection 139B(3)).

41. In so far as the acquisition of shares under the RISAP is concerned, the time at which the discount is included in the participating employee's assessable income depends on two material factors:

- The first is whether the shares are 'qualifying shares' within the meaning of that term of section 139CD; and
- The second is whether the taxpayer has made an election under section 139E to include the discount in assessable income in the year that the shares are acquired.

42. It is accepted that having regard to the conditions under section 139CD the shares acquired by the participating employee in the RISAP are qualifying shares.

#### **Where the participating employee does not make an election under section 139E**

43. Where a participating employee has not made an election under section 139E and as the shares are qualifying shares, the discount in relation to the shares is included in assessable income, pursuant to subsection 139B(3), in the year of income in which the cessation time occurs. As the shares are subject to forfeiture and there are restrictions preventing the participating employee from disposing of the shares, the cessation time is determined pursuant to subsection 139CA(2).

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44. Subsection 139CA(2) provides that the cessation time will be the earliest of:

- (a) the time when the taxpayer disposes of the share;
- (b) the later of:
  - (i) the time when any restrictions preventing the taxpayer from disposing of the share cease to have effect; and
  - (ii) the time when any condition that could result in the taxpayer forfeiting ownership of shares ceases to have effect;
- (c) the time when the employment in respect of which the share was acquired ceases;
- (d) the end of the 10 year period starting when the taxpayer acquired the share.

45. Where the shares are disposed of by the participating employee in an arm's length transaction within 30 days of the cessation time, the discount included in assessable income is calculated pursuant to subsection 139CC(3). As the participating employee has given no consideration for the acquisition of the shares, the amount or value of any consideration received from the disposal will be included in the participating employee's assessable income.

46. As the shares are qualifying shares and no election was made under section 139E in the year of income that the share was acquired, any capital gain or loss made on the disposal, outlined above, will be disregarded in accordance with subsection 130-83(2) of the ITAA 1997.

47. A participating employee who does not dispose of the shares in an arm's length transaction within 30 days of the cessation time will include the discount in their assessable income. The discount is calculated in accordance with subsection 139CC(4). The discount is the market value of the shares at cessation time as no consideration was paid by the participating employee to acquire the shares.

48. The ordinary shares in Record Investments Limited are listed on the ASX, which is an approved stock exchange. The market value of the shares for the purpose of paragraph (a) of subsection 139CC(4) is determined in accordance with section 139FA. Section 139FA provides that the market value is:

- if there was at least one transaction on the ASX in Record Investments Limited shares in the week up to and including the valuation date – the weighted average of the prices at which those shares were traded during that week; or
- if there was no transaction in Record Investments shares on the ASX in that period – the last offered price on the ASX for Record Investments Limited shares, or if no such offer was made, the value as determined under section 139FB.

49. The cost base of the shares for the purpose of the CGT provisions is determined in accordance with subsection 130-83(3) of the ITAA 1997, the first element being the market value of the shares worked out under section 139FA at cessation time. This is the market value determined in paragraph 48.

50. Where the participating employee acquires shares under the RISAP which are subsequently forfeited under the RISAP Rules, the discount to be included in assessable income pursuant to subsection 139B(3) will be nil. As the participating employee will receive no consideration upon forfeiture in the shares, nor paid anything for them, the discount calculated in accordance with subsection 139CC(3) is nil.

51. Likewise, the forfeiture of shares will have no CGT consequences because there will have been no acquisition of those shares by the employee as required by section 130-80 of the ITAA 1997. Pursuant to the rules for CGT event E5 in section 109-5 of the ITAA 1997 and section 104-75 of the ITAA 1997, the employee will not have acquired the shares because he or she did not become absolutely entitled to them.

#### **Where the participating employee does make an election under section 139E**

52. A participating employee can elect under section 139E that subsection 139B(2) applies for a year of income. Subsection 139B(2) includes the discount in assessable income in the year of income in which the share was acquired.

53. An election under section 139E must be made in writing in a form approved by the Commissioner, before the taxpayer lodges his or her return of income for the year of income in which the share was acquired or within such further time as the Commissioner allows. Taxpayers should not forward their section 139E elections to the Australian Taxation Office unless specifically requested to do so. (See paragraph 3 of Taxation Determination TD 97/23.)

54. Where an election is made by a participating employee under section 139E for a year of income, the discount given on all the qualifying shares acquired is included in the participating employee's assessable income in the income year in which the share was acquired.

55. The discount is calculated in accordance with subsection 139CC(2). The discount is the market value of the share, as determined by section 139FA (see paragraph 48), as at the time it was acquired by the participating employee no consideration was provided for the acquisition of the share by the participating employee.

56. Section 139CE contains three exemption conditions that must be satisfied by the RISAP for the participating employees to have access to the \$1,000 tax free threshold provided for in subsection 139BA(2). The RISAP does not satisfy these exemption conditions as it contains forfeiture and restriction on disposal conditions. As the RISAP does not satisfy section 139CE, subsection 139BA(2) will not apply to reduce the discount to be included in the participating employee's assessable income by \$1,000.

57. This discount is still included in assessable income even where in a subsequent year of income the shares are forfeited under the RISAP Rules.

58. The first element of the cost base of the shares for the purposes of the CGT provisions is determined in accordance with section 130-80 of ITAA 1997.

## **Detailed contents list**

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

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### **Commissioner of Taxation**

12 November 2003

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<i>Previous draft:</i>	- ITAA 1936 139CA(2)
Not previously issued in draft form	- ITAA 1936 139CC
	- ITAA 1936 139CC(2)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 139CC(3)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 139CC(4)
TR 97/16; TD 97/23	- ITAA 1936 139CD
	- ITAA 1936 139CE
<i>Subject references:</i>	- ITAA 1936 139E
- Employee share schemes	- ITAA 1936 139FA
	- ITAA 1936 139FB
	- ITAA 1936 139G
<i>Legislative references:</i>	- ITAA 1997 104-75
- ITAA 1936 Div 13A	- ITAA 1997 109-5
- ITAA 1936 139B	- ITAA 1997 130-80
- ITAA 1936 139B(2)	- ITAA 1997 130-83
- ITAA 1936 139B(3)	- ITAA 1997 130-83(2)
- ITAA 1936 139BA	- ITAA 1997 130-83(3)
- ITAA 1936 139BA(2)	- TAA 1953 Part IVAAA
- ITAA 1936 139C	- Copyright Act 1968
- ITAA 1936 139C(1)	- Pooled Development Fund Act 1992
- ITAA 1936 139C(3)	
- ITAA 1936 139CA	

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#### ATO references

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