

CR 2003/68 - Income tax: Centennial Coal Company Limited - Deferred Employee Share Plan



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Class Ruling

Income tax: Centennial Coal Company Limited – Deferred Employee Share Plan

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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

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 taxation laws dealt with in this ruling are:

- 139B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- 139BA of the ITAA 1936;
- 139C of the ITAA 1936;
- 139CA of the ITAA 1936;
- 139CC of the ITAA 1936;
- 139CD of the ITAA 1936;
- 139CE of the ITAA 1936;
- 139E of the ITAA 1936;
- 139FA of the ITAA 1936;
- 139FB of the ITAA 1936;
- 139G of the ITAA 1936;
- 139GF of the ITAA 1936;
- 104-75 of the *Income Tax Assessment Act 1997* (ITAA 1997);

- 109-5 of the ITAA 1997;
- 130-80 of the ITAA 1997; and
- 130-83 of the ITAA 1997.

Note; On December 5th 2002 Taxation Laws Amendment Bill (No. 8) 2002 was introduced into Parliament which amends the capital gains tax treatment of certain shares and rights acquired under employee share schemes in Division 13A. This ruling deals only with the law as presently enacted and which is not subject to the proposed amendments.

Class of persons

3. The class of persons to whom this ruling applies are all Australian resident employees ('participating employee') of Centennial Coal Company Limited and its associated companies ('the Centennial Coal group') who participate in the Centennial Coal Company Limited Deferred Employee Share Plan ('the Plan') as described in the arrangement part of this Ruling. The Centennial Coal Group comprises:

- Airly Coal Pty Limited;
- Berrima Coal Pty Limited;
- Centennial Angus Place Pty Limited;
- Centennial Fassifern Pty Limited;
- Centennial Hunter Pty Limited;
- Centennial Mandalong Pty Limited;
- Centennial Munmorah Pty Limited;
- Centennial Myuna Pty Limited;
- Centennial Newstan Pty Limited;
- Centennial Springvale Pty Limited;
- Centennial Springvale Holdings Pty Limited;
- Centennial Wyee Pty Limited;
- Charbon Coal Pty Limited;
- Clarence Coal Investments Pty Limited;
- Clarence Colliery Pty Limited;
- Clarence Coal Pty Limited;
- Coalex Pty Limited;

- Collieries Superannuation Pty Limited;
- Cook Coal Holdings Pty Limited;
- Elcom Collieries Pty Limited;
- Hartley Valley Coal Company Pty Limited;
- Huntley Colliery Pty Limited;
- Ivanhoe Coal Pty Limited;
- Japan Energy (Australia) Pty Limited;
- Mandalong Pastoral Management Pty Limited;
- Powercoal Pty Limited;
- Powercoal Employee Entitlements Company Pty Limited;
- Powercoal Superannuation Pty Limited; and
- Preston Coal Pty Limited.

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 9 to 19 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.
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Date of effect

8. This ruling applies from the 2002/2003 year of income. However, this 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 this 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 taxation laws are not amended.

Arrangement

9. The arrangement that is the subject of this Ruling is described below. The 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 11 November 2002;
- Centennial Coal Company Limited (ACN 003 714 538) Deferred Employee Share Plan Trust Deed; and
- Centennial Coal Deferred Employee Share Plan Information Booklet.

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.

10. The Plan is established as part of the employee share plan strategy of the Centennial Coal Group. The initial offer to acquire shares under the Plan was made to all Australian resident permanent full-time and part-time employees and directors of the Centennial Coal Group at 1 October 2002. Subsequent offers will be made at the discretion of the Centennial Coal Group.

11. Special discriminatory offers may also be made to select employees that have minimum service and performance conditions attached to aid in the retention and motivation of these employees.

12. The purchase of Centennial Coal Company Limited ordinary shares will be fully funded by way of an effective salary sacrifice arrangement within the meaning of paragraphs 19 to 23 of Taxation Ruling TR 2001/10. Participating employees are not required to contribute any other funds to acquire the ordinary shares.

13. CPU Share Plans Pty Limited ('CPU'/'the Plan Trustee') has been appointed to act as trustee in the implementation and administration of the Plan. The trust will be administered in a manner that ensures the sole activities of the trust are to acquire Centennial Coal Company Limited ordinary shares and to provide such ordinary shares to participating employees of the Centennial Coal Group. In this regard, any income or property to which a beneficiary is not presently entitled cannot be used for the administration of the Plan. The Centennial Coal Group will meet the brokerage fees on share purchases, along with all other share plan expenses, costs and charges incurred by the Plan Trustee. Employees will only be responsible for any costs in relation to selling or transferring any shares.

14. The Plan Trustee will use the funds it receives from the employer companies to purchase Centennial Coal Company Limited ordinary shares from new issues of shares by Centennial Coal Company Limited, from participants who have withdrawn shares from the Plan and wish to sell them or from dealings through the Australian Stock Exchange (ASX). The shares so acquired are registered in the name of the CPU.

15. Under the Plan shares are notionally allocated, as a beneficial interest, to the participating employees. The Plan Trustee notifies each participating employee in writing when ordinary shares are acquired and allocated to them, keeps proper books and records of their interest and provides them with an annual statement of account.

16. The Plan Trustee will not hold fractions of shares for the benefit of participating employees. Amounts remaining after share purchases are notionally carried forward on the employee's behalf to be used for future share purchases. Dividends paid by Centennial Coal Company Limited on Plan shares are distributed to participating employees with reference to the number of shares notionally allocated to them in the year that dividends are declared and paid. Dividends cannot be reinvested under the Plan.

17. The participating employee's beneficial interest in the shares is subject to:

- restrictions (shares must be held for a minimum of 12 months after allocation, unless the employee ceases employment with the Centennial Coal Group);

- the satisfaction of any relevant requirements (relevant requirements may be minimum service periods and performance criteria); and
- forfeiture - where the participant has committed an act of fraud, gross misconduct, or theft, or - where the relevant requirements have not been satisfied and the employee is no longer employed by the Centennial Coal Group for reasons other than retirement, redundancy, death or permanent disablement or other circumstances as determined by the Board, or - where the employee participates in another employee share plan operated by the Centennial Coal Group. In these circumstances, the Board can direct that the employee's Plan shares be forfeited.

18. Participating employees wishing to withdraw share benefits from the Plan must give the Plan Trustee a completed Withdrawal Notice. Whilst an employee continues in employment with the Centennial Coal Group a Withdrawal Notice can only be given to the Plan Trustee at any time after the relevant requirements have been satisfied. A Withdrawal Notice can be in respect of some or all of the shares if the employee holds at least \$2,000 worth of Plan Shares. If the employee has less than \$2,000 worth of Plan Shares then the Withdrawal Notice must be for all the shares. If the participating employee ceases to be an employee of the Centennial Coal Group, including for special circumstances such as retirement, redundancy, death or permanent disablement, the participant must give the Plan Trustee a Withdrawal Notice for all the shares if they have at least \$2,000 worth of shares. Where an employee has less than \$2,000 worth of shares, or more than \$2,000 worth of shares but does not give the Plan Trustee a Withdrawal Notice within 30 days of ceasing to be an employee of the Centennial Coal Group, the Plan Trustee will sell the shares and distribute the proceeds to them.

19. At no time will a participating employee hold a legal or beneficial interest in more than 5% of the shares of Centennial Coal Company Limited. Also at no time will an employee be in a position to cast or control the casting of more than 5% of the maximum number of votes at a general meeting of Centennial Coal.

Ruling

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

20. Where a participating employee does not make an election under section 139E for the year of income in which they acquire shares under the Plan, the discount given in relation to the shares is included in their assessable income in the year of income in which cessation time occurs, pursuant to subsection 139B(3).

21. As the shares acquired under the Plan are subject to restrictions and forfeiture conditions, the cessation time will be determined under subsection 139CA(2).

22. In accordance with subsection 139CA(2), the cessation time for a share will be the earliest of:

- the time when the Plan Trustee disposes of the shares;
- the time when the participating employee lodges a withdrawal notice with the Plan Trustee;
- the time when the employment in respect of which the share was acquired ceases; or
- 10 years after the participating employee acquired the share.

23. Where a 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 employee for the disposal of the shares.

24. Any capital gain or capital loss made as a consequence of such a disposal is disregarded pursuant to subsection 130-83(2) of ITAA 1997.

25. 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 worked out under section 139FA.

26. The first element of the cost base or reduced 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.

27. Where a participating employee forfeits shares acquired under the Plan in respect of which no section 139E election has been made, no amount is included in assessable income under subsection 139B(3) and there are no CGT consequences.

Where the participating employee makes an election under section 139E

28. Where a participating employee makes an election under section 139E for the year of income in which they acquire shares under the Plan, the discount given in relation to the shares is included in their assessable income in the year of income in which the shares are acquired pursuant to subsection 139B(2). This is the year of income in which the Plan Trustee allocates the shares to the employee.

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

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

31. The first element of the cost base or reduced cost base of the shares for the purposes of the CGT provisions will be determined in accordance with section 130-80 of the ITAA 1997. No advice is provided on the operation of this provision as it is currently subject to a retrospective legislative amendment contained in *Taxation Laws Amendment Bill (No. 8) of 2002*.

32. Where a participating employee forfeits shares acquired under the Plan in respect of which a section 139E election has been made, the discount given is included in assessable income under subsection 139B(2) as outlined above in paragraphs 28 and 29.

Explanation

Employee share schemes

33. Where, as under this arrangement, a participating employee acquires a beneficial interest in a share under an effective salary sacrifice arrangement for the purposes of Taxation Ruling TR 2001/10 there is an acquisition of a share under an employee share scheme for the purposes of Division 13A.

34. For the purposes of Division 13A, 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.

35. A participating employee acquires a share when it is allocated to them by the Plan Trustee. Clause 5.5 of the Deferred Employee Share Plan Trust Deed makes it clear that a participating employee acquires a beneficial interest in a share at the time the share is acquired under the Plan by the Plan Trustee for their benefit.

36. 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. This condition is satisfied with respect to shares acquired by participating employees under the Plan.

37. 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. This condition is satisfied under the Plan as participating employees are not required to make any payment for the allocation of the shares.

38. Therefore, participating employees acquire shares under an *employee share* scheme within the meaning in section 139C, as the shares are acquired by them for less than market value and in respect of or in relation to their employment.

39. Where a taxpayer acquires shares under an employee share scheme the discount given is included in assessable income in accordance with section 139B.

40. 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 in section 139CD. The second is whether the employee has made an election under section 139E to include the discount in assessable income in the year the shares are acquired.

41. A share is a qualifying share for the purposes of Division 13A if it meets the six conditions specified in section 139CD. Shares acquired under the Plan are qualifying shares because:

- they are acquired under an employee share scheme;
- the share is a share in a company which is the employer or the holding company of the employer of the participating employee;
- the shares are ordinary shares;

- at least 75% of the permanent employees of the employer have been eligible to acquire shares under the Plan;
- the restriction on ownership not exceeding 5% is complied with; and
- the restriction on voting power not exceeding 5% is complied with.

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

42. As Plan shares are qualifying shares, where a participating employee does not make an election under section 139E for the year of income in which the shares are acquired, the discount given in relation to the shares is included in assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3). The cessation time is determined under subsection 139CA(2) as the shares are subject to forfeiture and there are other restrictions preventing the employee disposing of them.

43. In accordance with subsection 139CA(2), the cessation time for a share acquired by a participating employee under the Plan will be the earliest of:

- the time when the Plan Trustee, on the employee's behalf, disposes of the share;
- the later of the time when the disposal restrictions cease and the forfeiture conditions expire in relation to the share, this will be when the employee lodges a withdrawal notice;
- the time when the employment in respect of which the share was acquired ceases. This being the time when the employee is no longer employed by the company that was their employer as the time the shares were acquired, unless the employee, on cessation of that employment is then employed by a member of the Centennial Coal Group, in which case, the time when they are no longer employed within the group, paragraph 139CA(2)(c) and subsection 139CA(3); and
- 10 years after the Plan Trustee allocated the share to the employee.

Disposal within 30 days of cessation time under an arm's length transaction

44. Subsection 139CC(3) calculates the discount to be included in assessable income where the shares are disposed of by the participating employee in an arm's length transaction within 30 days of the cessation time. As no consideration was paid or given by the participating employee for the shares, the proceeds received by the participating employee on disposal of the shares will be included in assessable income.

45. 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.

No disposal within 30 days of cessation time under an arm's length transaction

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

47. The ordinary shares in Centennial Coal Company Limited are listed on the Australian Stock Exchange (ASX), which is an approved stock exchange. Accordingly, the market value of the shares for the purposes of paragraph (a) of subsection 139CC(4), determined in accordance with section 139FA, is:

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

48. The cost base of the shares for the purposes of the CGT provisions will be 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 47.

Forfeiture of shares where no section 139E election made

49. Where a participating employee acquires shares under the Plan and the shares are subsequently forfeited under the Plan Rules, the discount to be included in assessable income pursuant to subsection 139B(3) is nil. The forfeiture by a participating employee of their shares triggers the cessation time for the shares and as the Plan Rules apply equally to all participating employees, the forfeiture by the participating employee is considered to be a disposal under an arm's length transaction for the purposes of Division 13A. However, as the participating employee does not receive any consideration upon forfeiture of the shares and has not paid or given any consideration for them, the discount calculated in accordance with subsection 139CC(3) is nil.

50. A forfeiture of shares will have no CGT consequences because there is no acquisition of the shares by the participating employee as required for section 130-80 to apply. The employee has not acquired the shares by becoming absolutely entitled to them pursuant to CGT event E5 in section 109-5, and section 104-75 of the ITAA 1997.

Where the participating employee makes an election under section 139E

51. 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 is acquired.

52. An election under section 139E must be made in writing in a form approved by the Commissioner, before the taxpayer lodges their return of income for the year of income 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.

53. 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 and qualifying rights acquired by them in that income year is included in their assessable income in the income year of acquisition.

54. The amount of the discount is calculated in accordance with subsection 139CC(2). As a participating employee does not provide any consideration for the acquisition of the shares acquired under the Plan, the discount is the market value of each share, as determined by section 139FA (see paragraph 47), when it was acquired by the employee.

\$1,000 tax-free threshold

55. Section 139CE contains three exemption conditions that must be satisfied by the Plan for the participating employees to have access to the \$1,000 tax-free threshold provided for in subsection 139BA(2). The Plan does not satisfy these exemption conditions as it:

- contains conditions which could result in participating employees forfeiting ownership of the shares, failing to satisfy subsection 139CE(2);
- permits employees to dispose of shares acquired under the Plan within three years of their acquisition, failing to satisfy subsection 139CE(3); and
- is not operated on a non-discriminatory basis under section 139GF, failing to satisfy subsection 139CE(4). This is because the Plan permits special discriminatory offers of shares to select employees.

As the Plan does not satisfy the exemption conditions in section 139CE, subsection 139BA(2) will not apply to reduce the discount to be included in the participant's assessable income by \$1,000.

Forfeiture of shares

56. The discount included in assessable income pursuant to subsection 139B(2) in the year of income in which a participating employee acquires the shares is not affected by a subsequent forfeiture of the shares.

57. The first element of the cost base of the shares for the purposes of the CGT provisions will be determined in accordance with section 130-80 of the ITAA 1997. No advice is provided on the operation of this provision as it is currently subject to a retrospective legislative amendment contained in *Taxation Laws Amendment Bill (No. 8) of 2002*.

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Detailed contents list

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Commissioner of Taxation

13 August 2003

Previous draft:

Not previously released in draft form.

*Related Rulings/Determinations:*TR 92/1; TR 92/20; TR 97/16;
TD 97/23; CR 2001/1; TR 2001/10

Subject references:

- Employee Share Schemes

Legislative references:

- ITAA 1936 Div 13A
 - ITAA 1936 139B
 - ITAA 1936 139B(2)
 - ITAA 1936 139B(3)
 - ITAA 1936 139BA
 - ITAA 1936 139BA(2)
 - ITAA 1936 139C
 - ITAA 1936 139C(1)
 - ITAA 1936 139C(3)
 - ITAA 1936 139CA
 - ITAA 1936 139CA(2)
 - ITAA 1936 139CA(2)(c)
 - ITAA 1936 139CA(3)
 - ITAA 1936 139CC
 - ITAA 1936 139CC(2)
 - ITAA 1936 139CC(3)
 - ITAA 1936 139CC(4)

- ITAA 1936 139CD
 - ITAA 1936 139CE
 - ITAA 1936 139CE(2)
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 - ITAA 1936 139E
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 - ITAA 1936 139G
 - ITAA 1936 139GF
 - ITAA 1997 104-75
 - ITAA 1997 109-5
 - ITAA 1997 130-80
 - ITAA 1997 130-83
 - ITAA 1997 130-83(2)
 - ITAA 1997 130-83(3)
 - TAA 1953 Part IVAAA
 - Copyright Act 1968
 - Taxation Laws Amendment Bill
 (No. 8) 2002

ATO references

NO: 2003/10153

ISSN: 1445-2014