


CR 2004/99 - Income tax: employee share scheme - Non-Executive Directors Share Plan: NRMA Insurance Group Limited

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Class Ruling

Income tax: employee share scheme – Non-Executive Directors Share Plan: NRMA Insurance Group Limited

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Preamble

*The number, subject heading, **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 tax laws dealt with in this Ruling are:

- section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 100 of the ITAA 1936;
- section 139B of the ITAA 1936;
- section 139BA of the ITAA 1936;
- section 139C of the ITAA 1936;
- section 139CA of the ITAA 1936;
- section 139CC of the ITAA 1936;
- section 139CD of the ITAA 1936;
- section 139CE of the ITAA 1936;
- section 139E of the ITAA 1936;
- section 139FA of the ITAA 1936;
- section 139FB of the ITAA 1936;
- section 139G of the ITAA 1936;

- section 160AQT of the ITAA 1936;
- section 160AQW of the ITAA 1936;
- section 160AQX of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-10 of the ITAA 1997;
- section 104-25 of the ITAA 1997;
- section 109-5 of the ITAA 1997;
- section 109-55 of the ITAA 1997;
- section 115-5 of the ITAA 1997;
- section 115-10 of the ITAA 1997;
- section 115-15 of the ITAA 1997;
- section 115-20 of the ITAA 1997;
- section 115-25 of the ITAA 1997;
- section 115-30 of the ITAA 1997;
- section 115-100 of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- section 130-80 of the ITAA 1997;
- section 130-83 of the ITAA 1997;
- section 207-40 of the ITAA 1997;
- section 207-45 of the ITAA 1997; and
- section 207-50 of the ITAA 1997.

Class of persons

3. The class of persons to whom this Ruling applies is non-executive directors of NRMA Insurance Group Limited (NIGL, now known as the Insurance Australia Group Limited), who participate in the NIGL NED (Non-Executive Directors) Share Plan (the Plan) described in the Arrangement section of this Ruling. In this Ruling this class of persons is referred to as the 'Participating Directors'.

4. This Ruling does not apply to a person who, immediately after first participating in the Plan, either holds a legal or beneficial interest in more than 5% of the shares in NIGL, or is in a position to cast or control the casting of more than 5% of the maximum number of votes that might be cast at a general meeting of NIGL.

Qualifications

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

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement described at paragraphs 10 to 25 is carried out in accordance with the details of the arrangement provided in this Ruling.

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

- (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

9. This Ruling applies from the 2000-2001 year of income. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement dispute agreed to before the date of issue of this 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 Public Ruling; or
- the relevant taxation laws are not amended.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on a number of 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:

- the Application for Class Ruling for the NED Share Plan (the Plan) dated 24 April 2001 (the Application);
- the Application for Class Ruling for the NED Share Plan dated 26 November 2001 (the Second Application);
- the NIGL Bonus Equity Share, Allocation Share, Equity Share, NED Share and Performance Award Rights Plans Trust Deed, executed 12 February 2001 (the Trust Deed);
- the NED Share Terms (Plan Share Terms);
- a letter from the Applicant dated 22 August 2001;
- a letter from the Applicant dated 29 August 2001; and
- an email from the Applicant dated 21 January 2004.

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

Features of the directors Share Plan

The Plan

11. The Plan is established as part of the employee share plan strategy of NIGL, the ultimate holding company of the NRMA Insurance Group (now known as the Insurance Australia Group). The initial offer to acquire shares under the plan was made to directors on 1 March 2001.

12. Participating Directors are those directors who have been invited by the Board to apply for NIGL shares in accordance with the terms of the Trust Deed for the Plan and have accepted the offer to do so.

13. Under the Plan the purchase of shares is funded by way of an effective salary sacrifice arrangement within the meaning of paragraphs 19 to 23 of Taxation Ruling TR 2001/10.

Plan Shares

14. In the Trust Deed, for the NIGL Bonus Equity Share, Allocation Share, Equity Share, NED Share and Performance Award Rights Plans (the Trust), Plan Shares in the non-executive directors share plan mean ordinary fully paid shares in the capital of NIGL and certain bonus shares. This ruling does **not** cover the taxation treatment of any bonus shares issued in respect of Plan Shares.

15. Plan Shares are allocated under this Plan on the terms set out in the Trust Deed.

16. NRMA Insurance Limited has made capital contributions to NRMA Share Plan Nominee Pty Ltd (now known as IAG Share Plan Nominees Pty Ltd), trustee of the Trust (the Trustee). The Trustee acquired NIGL shares, which were registered in the name of the Trustee on acquisition.

17. The Trustee allocates the shares acquired to the Participating Directors by crediting an account held for each. The Participating Directors acquire a beneficial interest in the shares in their accounts.

18. While the shares are held on trust on behalf of the Participating Directors, dividends that accrue to the shares are distributed to the Participating Directors.

19. The Application confirms that the Trust is to be administered in a manner that ensures the sole activities of the Trust are to acquire shares and to provide shares to Participating Directors of NIGL. In this regard, any income or property to which a Participating Director is not presently entitled will only be used for the administration of the Plan or for the purposes and operation of a successor employee share plan. Powers in the Trust Deed that may permit the Trustee to do otherwise will not be so exercised.

The Restriction Period

20. The shares are held by the Trustee on behalf of the Participating Director until a transfer or disposal is permitted under the Plan Share Terms and the Trust Deed. The date on which a director may call for the shares or direct their disposal is governed, in the main, by the ending of the '**Restriction Period**'. The Restriction Period ends, on the earliest of:

- (a) a fixed time not being less than 12 months and not exceeding 10 years from the date of the allocation of the share to the Participating Director determined by the Trustee at the time of allocation;
- (b) the Participating Director ceasing to be employed by NIGL or any member of the NIGL group; and
- (c) the Trustee determining that an event has happened as defined in the Plan.

21. There are five events which may end the Restriction Period. These are:

- (a) a takeover bid being made to shareholders in NIGL;
- (b) a person acquiring 15 per cent or more of the voting rights in NIGL;
- (c) a court orders a meeting in relation to the reconstruction of NIGL or its amalgamation with any other company;
- (d) a resolution for the voluntary winding up of NIGL being passed; or
- (e) an order being made for the compulsory winding up of NIGL.

22. With the exception of the Board's power to determine that an event has happened, neither the Trustee nor the Board of NIGL has any discretion to release Plan Shares before the end of the Restriction Period.

23. At the end of the Restriction Period, the Participating Director has a period of 2 months in which to call upon the Trustee to transfer the Plan Shares or to instruct the Trustee to sell the Plan Shares on their behalf. In the event that the necessary instructions are not given by the director within the 2 month notice period, the Trustee is required to transfer the Plan Shares to the director within a further month.

Forfeiture of the shares

24. Shares allocated to a Participating Director will be forfeited to the Trustee if the Participating Director's services are terminated for serious misconduct involving dishonesty.

25. Where shares are allocated to a Participating Director in respect of a period and the Participating Director ceases to be a director of NIGL before the end of the period beginning on the date of allocation, the shares will be forfeited by the Participating Director on a pro rata basis.

Ruling

[All legislative references are to the ITAA 1936 unless stated otherwise.]

Employee Share Schemes

26. Where a Participating Director acquires shares under the Plan, the shares are acquired under an employee share scheme for the purposes of section 139C. Any discount received in relation to such shares will not be included in the assessable income of a Participating Director pursuant to section 6-5 of the ITAA 1997, but will be included in assessable income as explained in paragraphs 27 to 47 of this ruling.

Participating Directors who make an election under section 139E***Taxation of the discount***

27. The discount given in relation to each share acquired under the Plan is included in the Participating Director's assessable income for the year of income during which the Trustee allocated the shares to the Participating Director (subsection 139B(2) applies).

28. The amount of the discount to be included is the market value of each share at the time that it was allocated to the Participating Director by the Trustee (subsection 139CC(2) applies). The market value of a share at this time is determined under section 139FA.

29. The amount included in assessable income is not subject to reduction under section 139BA.

Capital Gains Tax (CGT)

30. Where a share is disposed of by, or on behalf of, the Participating Director, a capital gain arises to the extent that the capital proceeds from the disposal exceed the cost base of the share. A capital loss occurs where the capital proceeds are less than the reduced cost base.

31. The first element of the cost base of a Plan Share is the market value of the share at the time the Participating Director acquired a beneficial interest in the share. The market value of the share at this time is determined under section 139FA (refer subsection 130-80(3) of the ITAA 1997).

32. Where a share is disposed of by, or on behalf of, the Participating Director at least one year after the Participating Director acquired a beneficial interest in the share, any gain on disposal will be a discount capital gain (section 115-5, section 109-55, and subsection 115-30(1) of the ITAA 1997 apply). The discount percentage for a discount capital gain is 50% (paragraph 115-100(a) of the ITAA 1997 applies).

Forfeiture

33. Where a share is forfeited prior to the Participating Director becoming absolutely entitled to it, no capital gain or loss will arise in relation to that share.

34. Where a share is forfeited after the Participating Director becoming absolutely entitled to it, a capital gain or capital loss may result. The capital proceeds in relation to the CGT event will be the market value of the share at the time of forfeiture (section 116-30 of the ITAA 1997 applies). The first element of the cost base or reduced cost base will be the market value of the share as indicated at paragraph 31.

Participating Directors who do not make an election under section 139E

Taxation of the discount

35. The discount given in relation to each share acquired under the Plan is included in the Participating Director's assessable income for the year of income in which the cessation time occurs (subsection 139B(3) applies).

36. The cessation time for a share will be the earlier of when:

- the share is disposed of by the Trustee on behalf of the Participating Director;
- the share is transferred to the Participating Director by the Trustee;
- the share is forfeited;
- the Participating Director is no longer employed by NIGL or another member of the NRMA Insurance Group; or
- the 10 year period starting when the taxpayer acquired the share ends.

37. Where a Participating Director, in an arm's length transaction, disposes of the shares at the cessation time or within 30 days of the cessation time, the discount included in their assessable income is the amount or value of the consideration received on the disposal (subsection 139CC(3) applies).

38. Where a share is forfeited, no amount of discount in relation to that share will be included in the Participating Director's assessable income (subsection 139CC(3) applies).

39. Where a Participating Director does not dispose of the shares in an arm's length transaction at the cessation time or within 30 days of the cessation time, the discount to be included in their assessable income is the market value of the shares at the cessation time (subsection 139CC(4) applies). The market value of a share at this time is determined under section 139FA.

Capital Gains Tax

40. Where a share is disposed of by, or on behalf of, the Participating Director, a capital gain arises to the extent that the capital proceeds from the disposal exceed the cost base of the share. A capital loss occurs where the capital proceeds are less than the reduced cost base.

41. Where in relation to a CGT event A1 the disposal of a share occurs under an arm's length transaction at or within 30 days after the cessation time, any capital gain or capital loss made from the disposal is disregarded (subsections 130-83(1) and (2) of the ITAA 1997 apply).

42. In circumstances where the disposal of a share occurs under a non-arm's length transaction or not within 30 days after the cessation time, the capital gain or capital loss is calculated on the basis of the first element of the cost base or reduced cost base being the market value of the share at the cessation time (subsection 130-83(3) of the ITAA 1997 applies). The market value of the share at this time is determined under section 139FA.

43. A capital gain on disposal will be a discount capital gain if the disposal of the share occurs at least one year after the Participating Director became absolutely entitled to it (section 115-5 of the ITAA 1997 applies). The discount percentage for a discount capital gain is 50% (paragraph 115-100(a) of the ITAA 1997 applies).

Forfeiture

44. Where a share is forfeited prior to the Participating Director becoming absolutely entitled to it, no capital gain or loss will arise in relation to that share.

45. Where a share is forfeited after the Participating Director becoming absolutely entitled to it, a capital gain or capital loss may result. The capital proceeds in relation to the CGT event will be the market value of the share at the time of forfeiture (section 116-30 of the ITAA 1997 applies). The first element of the cost base or reduced cost base is the market value determined under section 139FA at the cessation time. However, a capital gain or capital loss is disregarded if the share is forfeited at or within 30 days of the cessation time.

Dividends

46. A dividend received by the Trustee in respect of a Participating Director's share is assessable to the Participating Director in the year of receipt (Division 6 of Part III applies).

47. Where such a dividend is franked, subject to the imputation rules in Part IIIA of the ITAA 1936 and Part 3-6 of the ITAA 1997, an additional amount will be included in the Participating Director's assessable income and a franking rebate or tax offset allowed to the Participating Director in the year of receipt of the dividend.

Explanation

Employee share schemes

48. Division 13A of Part III of the ITAA 1936 provides for the taxation treatment of shares acquired under employee share schemes. Under Subdivision B of Division 13A, if a taxpayer has *acquired* a share or right under an *employee share scheme*, the assessable income of the taxpayer includes the discount given in relation to the share.

49. 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.

50. The Trust Deed and the Plan Share Terms make it clear that the Participating Director acquires a beneficial interest in a Plan Share at the time of allocation. For the purposes of Division 13A, the Participating Director acquired a share by it being allocated to their account by the Trustee.

51. 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.

52. It is considered that shares are acquired by participants in their capacity as directors and accordingly the employment condition in subsection 139C(1) is satisfied.

53. 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. For the purposes of subsection 139C(3) consideration paid or given by a Participating Director under the Plan does not include amounts sacrificed under an effective salary sacrifice arrangement. This condition is satisfied under the Plan as Participating Directors are not liable to make any other payment on acceptance of an offer for Plan Shares.

54. Therefore, Participating Directors acquire their shares under an employee share scheme.

55. Because any discount received in relation to such shares will be included in the assessable income of Participating Directors in accordance with Division 13A of Part III, it will not be included in assessable income pursuant to section 6-5 of the ITAA 1997.

Election made under section 139E

56. Where an election is made under section 139E for a year of income, subsection 139B(2) applies to determine when the discount with respect to all the qualifying shares or qualifying rights acquired in that year is assessed. A section 139E election, once made, allows a Participating Director to include the discount in their assessable income in the year that the share is acquired.

57. 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, or within such further time as the Commissioner allows. Notwithstanding this, paragraph 3 of Taxation Determination TD 97/23 provides that unless specifically requested to do so, taxpayers should not forward their section 139E elections to the Australian Taxation Office.

58. Where a taxpayer has acquired a share under an employee share scheme and subsection 139B(2) applies, the discount is

included in the taxpayer's assessable income of the year of income in which the share is acquired.

59. Accordingly, a Participating Director who has made an election under section 139E includes the discount given on their shares in their assessable income in the income year when they are acquired.

Time of acquisition

60. Division 13A does not specify the time at which a share is taken to have been acquired. Section 139G describes the circumstances in which a person acquires a share.

61. The Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1995 (the EM), which inserted Division 13A into the ITAA 1936, states at paragraph 2.29:

For the purposes of the new Division, a share or right is taken to have been acquired by a person ... when:

- the share or right is transferred to that person;
- the share is allocated to that person; or
- the right is created in that person.

A person is also taken to acquire a share or right when a person acquires a legal or beneficial interest in a share or right.

62. The events listed in this passage of the EM are the same as those listed in the section 139G definition of 'acquires'. It is implied from the EM that the time of acquisition of a share for Division 13A purposes will be the time of the event referred to in section 139G. In the case of a Participating Director this is when they acquire their beneficial interest which, as indicated above, is the time when the shares are allocated to their account by the Trustee.

Amount of the discount where election made

63. If subsection 139B(2) applies, the amount of the discount is calculated under subsection 139CC(2). This provides that the discount is the market value of the share at the time when it is acquired, less any consideration paid or given by the taxpayer as consideration for the acquisition.

64. As the Participating Director pays no consideration for the acquisition of their shares, the amount of the discount is the market value of the shares, at the time of allocation. The market value of NIGL shares, being quoted on a stock market of an approved stock exchange, is determined under section 139FA.

Market value under section 139FA

65. The market value of a share determined under section 139FA at a particular time is:

- if there is at least one transaction on the Australian Stock Exchange (ASX) in NIGL shares during the week up to and including the relevant time – the weighted average of the prices at which NIGL shares were traded during that period (paragraph 139FA(1)(a) applies);
- if there were no such transaction in the period specified – the last price at which an offer was made on the ASX in that period to buy a NIGL share (subparagraph 139FA(1)(b)(i) applies); or
- if there was no transactions in, or offers made to buy, NIGL shares on the ASX in the period specified – the arm's length value of the share as specified in a written valuer's report or calculated in accordance with an approved method under subsection 139FB(1) (subparagraph 139FA(1)(b)(ii) applies).

No tax-free threshold

66. As the Plan contains conditions that could result in a Participating Director forfeiting ownership of shares, the exemption conditions in section 139CE are not satisfied in relation to the shares. This means that a reduction under section 139BA of up to \$1,000 in the amount of the discount included in assessable income is not available to Participating Directors electing to be assessed in the year of acquisition under subsection 139B(2).

Election under section 139E not made

67. Under subsection 139B(2), the discount in relation to a share is included in the Participating Director's assessable income in the year of income in which the share is allocated to them (as set out above); unless subsection 139B(3) applies.

68. Subsection 139B(3) applies where the Participating Director has not made an election under section 139E and their share is a *qualifying share* (refer to paragraph 70).

69. If subsection 139B(3) applies, the discount is included in the Participating Director's assessable income in the year of income in which the *cessation time* occurs.

Qualifying shares

70. A share in a company is a qualifying share if the following six conditions are satisfied:

- (a) the share must have been acquired under an employee share scheme;
- (b) the company in which shares are being offered must be the employer, or the holding company of the employer of the Participating Director;
- (c) all the shares available for acquisition under the scheme must be ordinary shares;
- (d) at the time the share is acquired, at least 75% of the permanent employees of the employer must have been entitled, or at some earlier time had been entitled, to acquire:
 - shares under the scheme; or
 - shares or rights in the employer, or a holding company of the employer, under another employee share scheme;
- (e) immediately after the acquisition of the share, the relevant Participating Director does not hold a legal or beneficial interest in more than 5% of the company; and
- (f) immediately after the acquisition of the share, the relevant Participating Director is not in a position to cast, or control the casting of, more than 5% of the votes that might be cast at a general meeting.

71. The Commissioner accepts that the conditions in section 139CD are satisfied for all Participating Directors to whom this ruling applies in respect of shares acquired under the Plan for less than market value, as determined under section 139FA. Therefore, these shares are qualifying shares for the purposes of Division 13A.

72. As the shares are qualifying shares, subsection 139B(3) applies where the Participating Director has not made an election under section 139E. Under subsection 139B(3), the discount is included in the Participating Director's assessable income of the year of income in which the *cessation time* occurs.

Cessation time

73. Cessation time with respect to shares is defined by section 139CA. Because the Plan contains restrictions preventing Participating Directors from disposing of shares before a particular time and conditions which could result in forfeiture of the shares, the cessation time is the earliest of the times specified under subsection 139CA(2). Under subsection 139CA(2) the cessation time is the earliest of:

- (a) the time the Participating Director disposes of the share;
- (b) the time when any restriction preventing disposal of the share by the Participating Director and any forfeiture condition that could result in the Participating Director forfeiting ownership of the share cease to have effect;
- (c) (taking into account subsection 139CA(3)), the time when the Participating Director ceases to be employed by NIGL or another member of the NRMA Insurance Group; or
- (d) 10 years after the share was acquired.

Restriction preventing disposal

74. The time that restrictions preventing disposal ends depends upon the Trust Deed and the Plan Share Terms. The Plan Share Terms (reflecting similar provisions in Schedule 4 of the Trust Deed) prohibit any dealings by both the Trustee and the Participating Director in the Plan Shares, including assignment, transfer, sale, encumbrances or other dealing, except as permitted under Term 12 or as compelled by law. The restrictions on the disposal under these provisions *cease to have effect* at the earlier of when:

- the Trustee is given notice to sell the shares on behalf of the Participating Director under the Plan Share Terms. This may occur up to 2 months after the end of the Restriction Period;
- the shares are transferred to the Participating Director under the Plan Share Terms. This may occur up to 3 months after the end of the Restriction Period; or
- the shares are forfeited under the Plan Share Terms.

Forfeiture conditions

75. Shares under the Plan are allocated to the Participating Directors at the beginning of their period in office. If a Participating Director does not serve the full period of office, shares allocated to a Participating Director are forfeited on a pro-rata basis (commensurate with the proportion of the period not served).

76. Conditions that could result in the Participating Director forfeiting ownership of the shares are contained in the Plan Shares Terms. These condition *cease to have effect* at the earlier of when:

- the shares are forfeited; or
- the shares are no longer held by the trustee.

77. Taken as a whole then, the time when any restriction preventing disposal of the Plan Shares by the Participating Director and any condition that could result in the Participating Director forfeiting ownership of the Plan Share ceases to have effect is the earliest time that any one of the following events occurs:

- the Trustee on behalf of the Participating Director disposes of the Plan Share;
- the Plan Share is transferred to the Participating Director; or
- the Plan Share is forfeited.

Cessation time for a Plan Share

78. Accordingly, for a Plan Share, the cessation time will be the earlier of when:

- the share is disposed of by the Trustee on behalf of the Participating Director under the Plan Share Terms;
- the share is transferred to the Participating Director under the Plan Share Terms;
- the share is forfeited under the Plan Share Terms; or
- the Participating Director ceases to be employed by NIGL or another member of the NRMA Insurance Group; or
- the 10 year period starting when the taxpayer acquired the share ends.

Amount of the discount where election not made

79. Where subsection 139B(3) applies, the amount of the discount included in the Participating Director's assessable income is calculated under either subsection 139CC(3) or subsection 139CC(4).

Disposal at arm's length within 30 days

80. Under subsection 139CC(3), if the shares are disposed of by the Participating Director in an arm's length transaction at or within 30 days of the cessation time, the discount is the excess of the amount or value of any consideration received for the disposal, less any consideration paid or given by the Participating Director to

acquire the shares. For the purposes of subsection 139CC(3) the consideration paid or given by a Participating Director to acquire shares does not include amounts sacrificed under an effective salary sacrifice arrangement.

81. As the Participating Director provides no consideration for the acquisition of the Plan Shares, the amount of the discount in this instance will be the amount or value of any consideration received by the Participating Director on the disposal of the shares (such as the proceeds of sale).

82. The amount of the discount in relation to a Plan Share which has been forfeited will be calculated under subsection 139CC(3) if it can be said to have been disposed of by the Participating Director in an arm's length transaction at the time of forfeiture.

83. In *FC of T v. Wade* (1951) 84 CLR 105; (1951) 5 AITR 214; (1951) 9 ATD 337, Dixon and Fullagar JJ, when considering the term 'disposed of' in another provision of the ITAA 1936, said at CLR 110; AITR 219; ATD 340:

The words 'disposed of' are not words possessing a technical legal meaning, although they are frequently used in legal instruments. Speaking generally, they cover all forms of alienation.

84. In *Re Mal Bower's Macquarie Electrical Centre Pty Ltd (in liq)* (1974) CLC 27,771; [1974] 1 NSWLR 254 per LW Street CL in Equity at CLC 27,774; NSWLR 258, the concept of disposition was held to involve 'both a disponor and a disponee'. Often in cases of forfeiture, there will be no disponee (see for example *Mosaic Oil NL v. Angari Pty Ltd (No. 2) and Another* (1990) 8 ACLC 780 at 782; (1990) 20 NSWLR 280 at 284). However, under the Plan, Participating Directors will forfeit their Plan Shares to the Trustee, who may be seen to be a disponee.

85. In *Henty House Pty Ltd (in liq) v. FC of T* (1953) 88 CLR 141 at 151; (1953) 5 AITR 557 at 560; (1953) 10 ATD 231 at 236, the High Court held that the words 'disposed of' were not confined to a disposition by the taxpayer themselves. Notwithstanding this, under subsection 139CC(3) the relevant shares must be disposed of by the Participating Director. Under the Plan any forfeiture will arise out of the contractual terms agreed to by the Participating Director who, therefore, may be taken to have disposed of the Plan Shares upon forfeiture.

86. If the disposal upon forfeiture occurred in the course of an arm's length transaction, the value of the discount to be included in the Participating Director's assessable income upon a forfeiture will be determined under subsection 139CC(3).

87. *Pontifex Jewellers (Wholesale) Pty Ltd v. FC of T* [1999] FCA 1822; 99 ATC 5324; (1999) 43 ATR 643 summarises the distinction between the two ways the term 'arm's length' is commonly construed. One construction refers to the relationship of the parties to a transaction (that is, whether the parties are related in some way) and the other refers to the terms of a transaction between the parties (that

is, whether they are those that could be expected to arise between independent parties).

88. Under this arrangement it is the *transaction* which must be at arm's length. In determining whether a relevant transaction is at arm's length the entire circumstances surrounding the transaction must be considered: see *Granby v. FC of T* (1995) 129 ALR 503; 95 ATC 4240; (1995) 30 ATR 400 and *Collis v. FC of T* 96 ATC 4831; (1996) 33 ATR 438.

89. In the present circumstances, the forfeiture occurs under a term of the Plan which itself is an element of the total remuneration provided to Participating Directors. These remuneration terms were negotiated at arm's length. Like the relevant lease agreements in *Granby*, the forfeiture here occurred under the 'umbrella' of arm's length negotiations, and therefore may be said to have occurred in the course of an arm's length transaction.

90. As no consideration is received on forfeiture no discount will be included in a Participating Director's assessable income under subsection 139CC(3) in relation to a forfeited share where no election under section 139E is made.

Disposal not at arm's length or not within 30 days

91. Under subsection 139CC(4), if the shares are not disposed of by the taxpayer in an arm's length transaction, or not at or within 30 days of the cessation time, the discount is the excess of the market value of the share at the cessation time over the amount or value of consideration paid or given by the taxpayer to acquire the share.

92. As the Participating Director provides no consideration for shares, the value of the discount in this instance will be the market value of the share at the cessation time. The market value at this time is determined under section 139FA, as set out in paragraph 65.

Capital Gains Tax

Acquired for CGT

93. For the purpose of the CGT provisions, the Participating Directors 'acquire' a CGT asset at the time worked out under Division 109 of the ITAA 1997. In relation to a CGT asset that is held under a trust, the general acquisition rules provide that a beneficiary is considered to acquire the asset when they become absolutely entitled to it as against the trustee (see event number E5 in the table in subsection 109-5(2) of the ITAA 1997). This rule applies to shares held under employee share trusts subject to a limited exception applying where an election under section 139E has been made.

94. Where a share, being a qualifying share for Division 13A, was acquired from an employee share trust after 5 pm on 27 February 2001, the beneficiary is considered to have acquired the share for the purposes of determining the retention period under section 115-25 of the ITAA 1997 for discount capital gains at the time that they acquired their beneficial interest if the acquirer made an election under section 139E (see section 109-55, item 12 and subsection 115-30(1), item 8 of the ITAA 1997).

95. Participating Directors who make an election under section 139E to be taxed in the year of acquisition on a Plan Share acquired after 27 February 2001 will be taken to have acquired that share on the date that it was allocated to them by the trustee for the purposes of determining whether a capital gain made after they become absolutely entitled to the share is a discount capital gain.

Disposal

96. A Participating Director will make a capital gain on disposal of a share if the capital proceeds (such as proceeds from sale) from the disposal are more than the share's cost base.

97. If a share that has been acquired for CGT purposes is disposed of by, or on behalf of, a Participating Director, it will be a CGT event A1. Under subsection 104-10(4) of the ITAA 1997, the Participating Director will make a capital gain if the capital proceeds from the disposal are more than the asset's cost base. A capital loss will occur where the capital proceeds are less than the reduced cost base. Capital proceeds are defined under Division 116 of the ITAA 1997, and include proceeds from sale.

Forfeiture

98. If a share is forfeited before the Participating Director is absolutely entitled to it, no capital gain or loss will arise in relation to that share. This is because the share will not have yet been acquired for CGT purposes.

99. If a share is forfeited after it has been acquired by the Participating Director for CGT purposes it will be a CGT event C2. This may occur, for example, if the Participating Director is dismissed for serious misconduct after the end of the Restriction Period, but while the share is still being held by the Trustee. In this situation, under subsection 104-25(3) of the ITAA 1997, the Participating Director will make a capital gain if the proceeds from the ending of the ownership are more than its cost base. A capital loss will result if the capital proceeds are less than the reduced cost base.

100. The proceeds from such an event will be deemed by section 116-30 of the ITAA 1997 to be the market value of the share at the time of forfeiture. Market value for these purposes is the price that would be agreed to between willing, but not anxious, parties; see *Spencer v. The Commonwealth* (1907) 5 CLR 418; (1907) 14 ALR 253.

Whether discount Capital Gain

101. Under section 115-5 of the ITAA 1997, a capital gain will be a discount capital gain if:

- (a) it is made by an individual, trust, or complying superannuation fund (refer to section 115-10 of the ITAA 1997);
- (b) it is made from a CGT event occurring after 21 September 1999 (refer to section 115-15 of the ITAA 1997);
- (c) the cost base elements have not been indexed (refer to section 115-20 of the ITAA 1997); and
- (d) the relevant CGT asset was acquired at least 12 months before the CGT event (refer to section 115-25 of the ITAA 1997).

102. Conditions (a) to (c) will be satisfied by a Participating Director in relation to Plan Shares acquired under the employee share scheme.

103. Therefore, any gain made on the disposal of a share by, or on behalf of, a Participating Director will be a discount capital gain if the share was held for at least 12 months after the time it was acquired for the purposes of Division 115 of the ITAA 1997.

Capital Gains Tax consequences – election made under section 139E

104. Subdivision 130-D of Part 3-3 of the ITAA 1997 sets out specific rules in regard to shares acquired at a discount under an employee share scheme. Where the Participating Director has made an election under section 139E 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 the ITAA 1997.

105. Under section 130-80 of the ITAA 1997, the first element of the cost base or reduced cost base will be the market value of the share at the time it is acquired (when the Participating Director acquired a beneficial interest in it). The market value at this time is determined under section 139FA, as set out in paragraph 65.

106. If the proceeds on disposal of a share acquired for CGT purposes exceed this cost base, the Participating Director will make a capital gain. This will be a discount gain, as set out in paragraph 103, if the share was held for at least 12 months after the Participating Director acquired their interest in the share.

Capital Gains Tax consequences – election not made under section 139E

107. Section 130-83 of the ITAA 1997 provides that if the share is a qualifying share (which a Plan Share is – refer to paragraph 71), an election is not made under section 139E, and CGT event A1, C2, E1, E2 or E5 happens in relation to the share in an arm's length transaction at, or within, 30 days of the cessation time any capital gain or capital loss the Participating Director makes on the disposal is disregarded.

108. Therefore, if the share is disposed of in an arm's length transaction at, or within, 30 days of the cessation time no capital gain or loss will arise in relation to that share. This also applies to a forfeiture occurring at or within 30 days of the cessation time.

109. Where a Participating Director does not make an election under section 139E and the share is not so dealt with at or within 30 days of the cessation time, the effect of section 130-83 of the ITAA 1997 is that the first element of the cost base or reduced cost base of the share is its market value at the cessation time. The market value at this time is determined under section 139FA, as set out in paragraph 65.

110. If the capital proceeds for the CGT event exceed this cost base, the Participating Director will make a capital gain. This will be a discount gain, as set out in paragraph 103, if the share was held for at least 12 months after the Participating Director became absolutely entitled to it.

Tax consequences of payment of a dividend by NIGL

111. The Trust Deed provides that while shares are held on trust for Participating Directors all dividends received in respect of those shares will be distributed to such directors.

112. Dividends received by the Trustee with respect to a Participating Director's Plan Shares will be fully assessable to the Participating Director in the year of receipt under section 97 or section 100, as is appropriate.

Gross-up and tax offset from 1 July 2002

113. Where the relevant dividend is franked the assessable income of the trustee, for the year in which the distribution is made, includes an amount equal to the franking credit on the dividend under subsection 207-40(2) of the ITAA 1997. This additional amount grosses-up the dividend received to take account of the company tax already paid in respect of that dividend.

114. In this case, subsection 207-45(1) of the ITAA 1997 operates to include the Participating Director's share of the franking credit in assessable income, while section 207-50 of the ITAA 1997 generally allows the Participating Director a tax offset equal to this amount.

Gross-up and franking rebate prior to 1 July 2002

115. Where the relevant dividend is franked the net income of the trust estate includes an additional amount under section 160AQT if the Trustee is a qualified person under Division 1A of Part IIIAA. This additional amount grosses-up the dividend received to take account of the company tax already paid in respect of that dividend.

116. In this case, a share of the additional amount will be included in the Participating Director's assessable income under section 160AQW (or included in the section 100 amount if the Participating Director is under a legal disability). In addition, the Participating Director will be entitled to a franking rebate under section 160AQX if they are also a qualified person under Division 1A of Part IIIAA in relation to the relevant franked dividend.

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Previous draft:

Not previously issued as a draft

Previous Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 97/16; TR 2001/10; TD 97/23

Subject references:

- absolute entitlement
- acquisition of shares
- capital gains tax
- CGT cost base
- CGT discount
- CGT event
- CGT event A1
- CGT event C2
- CGT event E1
- CGT event E2
- CGT event E5
- cost base
- disposal of shares
- employee share schemes & options
- forfeiture of rights & entitlements
- franked dividends
- franking rebates
- imputation credits
- imputation system
- income
- share discounts on employee share schemes
- shareholders
- shares
- trust distributions
- trustees
- trusts

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