CR 2006/130 - Income tax: Qantas Deferred Share Plan - 2005 Performance Rights

Class Ruling

Income tax: Qantas Deferred Share Plan – 2005 Performance Rights

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This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 139B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 139BA of the ITAA 1936;
- section 139C of the ITAA 1936;
- section 139CB of the ITAA 1936;
- section 139CC of the ITAA 1936;
- section 139CD of the ITAA 1936;
- section 139CE of the ITAA 1936;
- section 139DD of the ITAA 1936;
- section 139E of the ITAA 1936;

- section 139FA of the ITAA 1936;
- section 139FB of the ITAA 1936;
- section 139FC of the ITAA 1936;
- section 139FE of the ITAA 1936;
- section 139G of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-25 of the ITAA 1997;
- section 109-5 of the ITAA 1997;
- section 109-10 of the ITAA 1997;
- section 112-20 of the ITAA 1997;
- section 115-25 of the ITAA 1997;
- section 115-100 of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- section 130-60 of the ITAA 1997;
- section 130-80 of the ITAA 1997;
- section 130-83 of the ITAA 1997; and
- section 974-75 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies is all persons who are employees of the Qantas Group (excluding executive directors), who participate in the Qantas Deferred Share Plan – 2005 Performance Rights. In this Ruling, a person belonging to this class of entities is referred to as a participating employee. The Qantas Group comprises:

- Qantas Airways Limited (Qantas);
- Eastern Australia Airlines Pty Limited;
- Jetstar Airways Pty Limited;
- Express Ground Handling Pty Limited; and
- Sunstate Airlines (QLD) Pty Limited.

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 31 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

8. This Ruling applies from the income year (as defined in subsection 995-1(1) of the ITAA 1997) ended 30 June 2006. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Related Rulings

12. Class Ruling CR 2005/99 Income tax: Qantas Deferred Share Plan – 2003/04 Performance Rights Plan Rules.

Scheme

13. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- the application for Class Ruling dated 21 April 2006;
- Qantas Deferred Share Plan Terms and Conditions (DSP);
- Qantas Deferred Share Plan – 2005 Performance Rights Plan Rules (2005 PRP Rules);
- correspondence from Qantas Airways Ltd dated 9 June 2006;
- correspondence from Qantas Airways Ltd dated 19 June 2006;
- Qantas Code of Conduct and Ethics;
- correspondence from Qantas Airways Ltd dated 28 August 2006;
- correspondence from Qantas Airways Ltd dated 24 November 2006; and
- correspondence from Qantas Airways Ltd dated 28 November 2006.

These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

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.

14. The DSP was established as part of the employee share plan strategy of the Qantas Group and provides a platform for a broader based delivery of equity ownership to employees.

15. The DSP commenced on 17 October 2002.

16. Under the DSP the Qantas Board (the Board) may from time to time offer shares or grant rights to an eligible employee subject to such conditions as it determines.

17. The 2005 PRP Rules (in conjunction with the DSP) provide that rights (performance rights) are granted to participating employees when such rights are offered to eligible employees (excluding executive directors) of the Qantas Group.

18. The applicant has advised that the performance rights granted to the participating employees under the DSP meet the conditions of section 139CD.

19. The participating employees pay no consideration to acquire the performance rights, which are personal to the participating employee and cannot be transferred, assigned or sold.

20. A performance hurdle described in the 2005 PRP rules must be met prior to the vesting of the performance rights. The performance hurdle is first tested as at 30 June 2008 and re-tested at quarterly intervals over the subsequent two year period ending as at 30 June 2010.

21. To the extent that the performance hurdle has been achieved, a performance right will vest following the tenth anniversary from the date of allocation, provided the participating employee does not commit an act of gross misconduct in relation to the Group. However, where a participating employee ceases employment before a performance right vests, such a right may not vest as above, because it may have lapsed as described in paragraph 28 of this Ruling.

22. Where a participating employee ceases employment with the Qantas Group before achievement of the performance hurdle, due to special circumstances as defined in the DSP, the CEO has (at that time), an absolute discretion to resolve that the performance rights vest.

23. Subject to the achievement of the Performance Hurdle, the participating employee may request that the Board exercise its discretion to vest performance rights (to the extent that the performance hurdle has been achieved) prior to the tenth anniversary from the date of allocation by completing a request to vest performance rights.

24. Performance rights which vest will automatically be converted to shares. These shares will be acquired on-market by Qantas at no cost to the participating employees.

25. The applicant has advised that various procedures introduced since 2002 have been implemented under the Qantas Code of Conduct and Ethics – Insider Trading Policy. The procedures are intended to restrict the sale of Qantas securities by participating employees who are in possession of material, non-public information. Material, non-public information is information that could or would be likely to influence persons in deciding to buy or sell Qantas securities.

26. From February 2006, a range of identified Qantas group finance staff (finance employees) are required to obtain approval to sell Qantas securities. Approval is subject to the non holding of material, non-public information.

27. From July 2006, a revised process that applies to an expanded range of identified directors, executives and senior staff (expanded nominated employees) requires them to seek formal approval from the CEO (or his delegated nominee) to sell Qantas securities. The request must state that at the time they do not believe they are in possession of material, non-public information.

28. Performance rights will lapse:

a) if the participating employee ceases employment with the Qantas Group (for exceptions refer to paragraph 30 of this Ruling); or

b) if the participating employee commits an act of gross misconduct in relation to the Group; or

c) if the performance hurdle is not met after testing by the Board.

29. Unless the Board otherwise determines, when a performance right lapses all rights of the participating employee under the DSP in relation to the performance right cease and no consideration or compensation will be payable for, or in relation to, that lapse.

30. Performance rights will not lapse due to ceasing employment where:

- the participating employee is employed by the Qantas Group after any testing dates that has resulted in some or all of the performance hurdles being achieved and the participating employee completes a request to vest performance rights prior to cessation of employment; or
- due to special circumstances (as defined in the DSP) associated with the ceasing of employment, the CEO resolves that the performance rights will vest.

31. The applicant states that the 2005 PRP rules operating in conjunction with the DSP do not satisfy the exemption conditions in section 139CE.

Ruling

32. A right acquired under the DSP will be a right acquired under an employee share scheme and will be a qualifying right for the purposes of section 139CD. For the purposes of Division 13A of Part III (Division 13A) a performance right is acquired by a participating employee at the time the performance right is granted.

33. A share acquired by a participating employee as a result of the conversion by exercise of a performance right will not be a share acquired under an employee share scheme, pursuant to subsection 139C(4). The share will be acquired by the participating employee at the time it is allotted or transferred to them.

Where an employee makes an election

34. Where a participating employee makes an election under section 139E, the discount given in relation to a performance right acquired is included in the participating employee's assessable income in the year of income in which the performance right is acquired, pursuant to subsection 139B(2).

35. The discount included in the participating employee's assessable income will be an amount equivalent to the market value of the performance right at the time of acquisition, pursuant to subsection 139CC(2).

36. Subsection 139BA(2) will not apply to reduce the discount included in the participating employee's assessable income.

Capital gains tax

37. A performance right will be acquired by a participating employee for capital gains tax (CGT) purposes at the time the performance right is granted. For the purposes of CGT, the right is a convertible interest.

38. Any capital gain or capital loss made by the participating employee on the conversion of a performance right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

39. Where a share acquired, as a result of the conversion by exercise of the performance right, is disposed of by the participating employee, a capital gain will arise where the capital proceeds from the disposal are more than the cost base of the share. Pursuant to subsection 130-60(1) of the ITAA 1997 the first element of the cost base or reduced cost base of the share will be the cost base of the performance right at the time of the conversion.

40. Where the disposal of the share acquired as a result of conversion by exercise of the performance right occurs 12 months or more after the date of acquisition of the share, any capital gain that results from the disposal will be a discount capital gain subject to meeting the requirements of Subdivision 115-A of the ITAA 1997.

Lapse of rights

41. Where a participating employee acquires a performance right and it lapses without having been exercised, the amount of the discount may be excluded from the participating employee's assessable income, pursuant to section 139DD.

42. The participating employee will not make a capital gain or capital loss in relation to the performance right lapsing.

Where an employee does not make an election

43. Where a participating employee has not made an election under section 139E, the discount given in relation to a performance right will be included in the participating employee's assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

44. The cessation time will be the earlier of:

- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2);
- the time when any disposal restriction on a share (acquired on conversion by exercise of a performance right) cease to have effect, that are in effect or imposed on participating employees who are finance employees or expanded nominated employees, under the Qantas Code of Conduct and Ethics at the time the share is acquired, where those participating employees are, at that time, in possession of material, non-public information;
- if there are no disposal restrictions as outlined above, the time the performance right is converted by exercise; and
- the end of the 10 year period starting when the participating employee acquired the performance right.

Disposal within 30 days of cessation time

45. Where a performance right is converted by exercise and the participating employee disposes of the share (acquired as a result of the performance right being exercised) in an arm's length transaction at, or within 30 days of the cessation time, the discount assessable to the participating employee on the performance right is the amount of consideration received on disposal of the share, pursuant to subsection 139CC(3).

Capital gains tax

46. Any capital gain or capital loss made by the participating employee on the conversion by exercise of a performance right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

47. Any capital gain or capital loss made as a consequence of an arm's length disposal within 30 days of the cessation time of a share acquired as a result of the conversion of the performance right will be disregarded, pursuant to subsection 130-83(2) of the ITAA 1997.

Disposal after 30 days of cessation time

48. Where the cessation time occurs on the conversion by exercise of the performance right and the share acquired as a result of the exercise of the right is disposed of by the participating employee more than 30 days after the cessation time, or in a non-arm's length transaction, the discount on the performance right is the market value of the share acquired at the cessation time, calculated in accordance with section 139FA.

49. If the performance right is exercised after the cessation time and the share acquired as a result of the exercise of the right is disposed of by the participating employee more than 30 days after the cessation time, or in a non-arm's length transaction, the discount assessable to the participating employee will be the market value of the right at the cessation time.

Capital gains tax

50. Any capital gain or capital loss made by the participating employee on the conversion by exercise of a performance right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

51. Where a participating employee disposes of the share acquired as a result of the conversion of the performance right more than 30 days after the cessation time, or in a non-arm's length transaction, a capital gain or capital loss may arise pursuant to subsection 104-10(4) of the ITAA 1997.

52. The first element of the cost base of the share acquired as a result of the conversion of the performance right will be the cost base of the right at the time of conversion pursuant to subsection 130-60(1) of the ITAA 1997.

53. Where any share acquired as a result of the conversion of the performance right is disposed of 12 months or more after acquisition of the share, any capital gain that results from the disposal will be a discount capital gain subject to meeting the requirements of Subdivision 115-A of the ITAA 1997.

Lapse of rights

54. Where a performance right lapses, in respect of which no section 139E election has been made, no amount is included in assessable income under subsection 139B(3).

55. The participating employee will not make a capital gain or capital loss in relation to the performance right lapsing.

Commissioner of Taxation
20 December 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

56. A right will be acquired under an employee share scheme, pursuant to Division 13A, if it is:

- acquired within the meaning of section 139G;
- acquired in respect of the employment of an employee pursuant to subsection 139C(1); and
- acquired for less than the market value pursuant to subsection 139C(3).

57. Section 139G provides that a person will acquire a right in several circumstances, including when another person creates the right in the employee or they acquire a legal interest in the right from another person.

58. Under the 2005 PRP Rules, performance rights are granted to participating employees at the time they are offered. Thus, the performance rights are acquired at this time within the meaning of section 139G.

59. The DSP was established as part of the employee share scheme strategy of the Qantas Group and provides a platform for a broader based delivery of equity ownership to employees. As such, any performance right acquired is considered to be acquired by a participating employee in respect of their employment.

60. As no consideration is paid or given by a participating employee to acquire the performance right, the participating employee will not acquire the performance right for market value.

61. For the purposes of this Ruling, the Commissioner accepts the statement by the applicant that the conditions in section 139CD are met in relation to the performance rights. Thus, a participating employee will acquire a qualifying right when a performance right is granted.

62. Where a participating employee acquires a performance right the discount given in relation to the right is included in the assessable income of the participating employee, pursuant to subsection 139B(1).

63. As the performance right is a qualifying right, the year of income in which the discount is included in the participating employee's assessable income and the amount of the discount depend on whether the participating employee has made a section 139E election covering the acquisition of the performance right.

Where an employee makes an election

64. A participating employee can elect under section 139E that subsection 139B(2) applies in respect of a performance right acquired by them in a year of income. Subsection 139B(2) provides that the discount in relation to a right is included in the employee's assessable income in the year of income in which the performance right is acquired.

65. The amount of the discount to be included in the participating employee's assessable income is calculated in accordance with subsection 139CC(2). The discount is the market value of the performance right at the time it was acquired by the participating employee less any consideration (if any) paid or given by the participating employee for the acquisition of the right.

66. Subdivision F of Division 13A contains special provisions to determine the market value of a right on a particular day. As the performance right will not be quoted on an approved stock exchange, the market value of the right will be determined in accordance with section 139FC or section 139FE.

67. As the performance right has a nil exercise price, the market value of the right is determined pursuant to subsection 139FE(1) and will be equal to the market value (determined under section 139FA) of a Qantas share on the day the performance right was granted.

68. As Qantas shares are listed on the Australian Stock Exchange (ASX), section 139FA provides that their market value will be:

- if there was at least one transaction on the ASX in those shares in the week up to and including the date of acquisition - the weighted average of the prices at which those shares were traded on the ASX during that week;
- if there were no such transactions in the week up to and including the date of acquisition - the last price at which an offer was made on the ASX in that period to buy such a share; or
- if no offer was made, the value as determined under section 139FB.

69. Where an employee makes an election under section 139E and the exemption conditions in section 139CE are satisfied in relation to the right, subsection 139BA(2) will apply to reduce the discount included in assessable income by up to $1,000.

70. Qantas has stated that the exemption conditions in section 139CE are not satisfied in relation to the 2005 PRP rules and as such subsection 139BA(2) does not apply to performance rights.

Capital gains tax

71. The participating employee will acquire a CGT asset, pursuant to subsection 109-5 of the ITAA 1997, at the time a performance right is granted. For CGT purposes the right is a convertible interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997.

72. Pursuant to subsection 130-80(2) of the ITAA 1997, the first element of the cost base of the performance right will be the market value of the right worked out under sections 139FA to 139FF at the time the participating employee acquires the right.

73. Any capital gain or capital loss made by the participating employee on the conversion of a performance right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

74. A performance right will be converted when the right vests as described in paragraphs 21 to 23 of this Ruling and the right is automatically converted to a share by Qantas.

75. A capital gain or capital loss may arise on the disposal of the share acquired as a result of the conversion of the performance right, pursuant to subsection 104-10(4) of the ITAA 1997.

76. Where shares are allotted or transferred to a participating employee as a result of a performance right being converted the participating employee will acquire a CGT asset at that time, pursuant to subsections 109-5 and 109-10 of the ITAA 1997.

77. Where the participating employee disposes of a share acquired as a result of conversion of the performance right, a capital gain will arise pursuant to subsection 104-10(4) of the ITAA 1997, if the capital proceeds from the disposal of the share exceed the cost base of the share. A capital loss will arise if the reduced cost base exceeds the capital proceeds received.

78. The first element of the cost base of the share will be the cost base of the performance right at the time of conversion, pursuant to subsection 130-60(1) of the ITAA 1997.

79. Where the participating employee disposes of a share acquired as a result of the conversion of the performance right, any capital gain arising from the disposal will be a discount capital gain if it satisfies the requirements of Subdivision 115-A of the ITAA 1997.

80. Pursuant to subsection 115-25(1) of the ITAA 1997, any capital gain the participating employee makes on the disposal of the share acquired as a result of the conversion of the performance right will be a discount capital gain if the disposal of the share occurs 12 months or more after acquisition of the share. The discount percentage for the participating employee will be 50%, pursuant to section 115-100 of the ITAA 1997.

Lapse of rights

81. Where a participating employee acquires a performance right and it lapses without having been exercised, section 139DD applies to deem the performance right to never have been acquired for the purposes of Division 13A.

82. As a consequence, the amount of any discount previously assessed in relation to a performance right that lapses, can be excised from the participating employee's assessable income by an amended assessment. Subsection 139DD(4) provides that the discount can be excluded from the participating employee's assessment at any time.

83. The lapse of a participating employee's performance right in accordance with the 2005 PRP rules (in conjunction with the DSP) will constitute the ending of an intangible CGT asset (CGT event C2). Thus, pursuant to subsection 104-25(3) of the ITAA 1997, the participating employee may make a capital gain or a capital loss on the lapse of a performance right.

84. However, as the participating employee's lapsed performance right is deemed never to have been acquired for the purposes of Division 13A (pursuant to section 139DD), Subdivision 130-D of the ITAA 1997 has no application and any capital gain or capital loss is determined under Part 3-1 of the ITAA 1997.

85. The first element of the cost base of the performance right will be nil as a participating employee does not provide any consideration for the acquisition of the right. The market value substitution rule has no application, pursuant to Item 5 in the table in subsection 112-20(3) of the ITAA 1997.

86. Whilst a participating employee will not receive any capital proceeds from the lapse of the performance right, the market value substitution rule will not apply as it is accepted that the lapse of the right constitutes an ending by expiry, pursuant to subsection 116-30(3) of the ITAA 1997.

87. As such a participating employee will not make a capital gain or capital loss where a performance right lapses in accordance with the 2005 PRP rules (in conjunction with the DSP).

Where an employee does not make an election

88. Where a participating employee acquires a performance right and does not make an election under section 139E, the discount given in relation to the right is included in the participating employee's assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

89. The cessation time is determined in accordance with subsection 139CB(1). As the share acquired by a participating employee (as a result of the conversion by exercise of a performance right) is not subject to forfeiture, the cessation time will be the earlier of:

- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2);
- the time when any disposal restrictions on a share (acquired on conversion by exercise of a performance right) cease to have effect, that are in effect or imposed on participating employees who are finance employees or expanded nominated employees, under the Qantas Code of Conduct and Ethics – Insider Trading Policy. This will only apply to restrictions imposed or in place at the time the share is acquired (on conversion by exercise of the performance right), in relation to participating employees who are finance employees or expanded nominated employees, and who, at that time are in possession of material, non-public information;
- if there are no disposal restrictions that are in effect or imposed on participating employees who are finance employees or expanded nominated employees, under the Qantas Code of Conduct and Ethics – Insider Trading Policy, the time when the performance right is converted by exercise; and
- the end of the 10 year period starting when the participating employee acquired the right.

90. Participating employees who are finance employees or expanded nominated employees, and who are not in possession of material, non-public information at the time a share is acquired (on conversion by exercise of a performance right) and who subsequently acquire material, non-public information at any time after the share is acquired, will not be considered to be subject to additional disposal restrictions for the purposes of determining when a cessation time occurs for a performance right under subsection 139CB(1).

91. The exercising of the performance right occurs when it vests and the time when the right is automatically converted to a share by Qantas may be a cessation time.

92. The amount of the discount to be included in a participating employee's assessable income is determined under section 139CC and will depend on whether the right, or any share acquired as a result of the exercise of the right, is disposed of in a non-arm's length transaction within 30 days of the cessation time.

Disposal within 30 days

93. Where a participating employee disposes of a share acquired as a result of the exercise of the performance right, in an arm's length transaction within 30 days of the cessation time, the discount to be included in assessable income is determined in accordance with subsection 139CC(3).

94. The discount will be the amount or value of any consideration they receive for the disposal of the share less the amount of any consideration they have paid or given to acquire or exercise the right.

95. As the participating employee does not provide any consideration to acquire the performance right or to exercise that right the discount to be included in the participating employee's assessable income will be the amount or value of any consideration they receive for the disposal of the share acquired as a result of the exercise of the performance right.

Capital gains tax

96. In accordance with paragraph 71 of this Ruling, for the purposes of CGT, a performance right is a convertible interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997. Any capital gain or capital loss made by the participating employee on the conversion of a performance right, being a convertible interest, is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

97. Subsection 130-83(2) of the ITAA 1997 provides that if a CGT event (for example a disposal) happens in relation to a share acquired as a result of the conversion of a performance right, within 30 days of the cessation time and in an arm's length transaction, then any capital gain or capital loss from the CGT event is disregarded.

Disposal after 30 days

98. Where the cessation time occurs on exercise of the performance right and the share acquired as a result of the exercise of the right is not disposed of by the participating employee at, or within, 30 days of the cessation time, or is disposed of in a non-arm's length transaction, the discount on the performance right will be the market value of the share at the cessation time (see paragraphs 66 and 67 of this Ruling).

99. Where a performance right is exercised after the cessation time and any share acquired as a result of the exercise of the right is not disposed of at, or within 30 days of the cessation time, or in a non-arm's length transaction, the discount in respect of the performance right is determined under subsection 139CC(4).

100. The amount of the discount will be the market value of the performance right at the cessation time less the amount of any consideration they have paid or given to acquire the right. As the participating employee does not pay any consideration to acquire the right the discount will be the market value of the performance right at the cessation time.

101. The market value of the performance right is calculated pursuant to section 139FC. As a performance right has a nil exercise price the market value of the right will be equal to the market value of a share that may be acquired by exercising the right, calculated in accordance with section 139FA (see paragraphs 66 to 68 of this Ruling).

Capital gains tax

102. Any capital gain or capital loss made by the participating employee on the conversion by exercise of a performance right more than 30 days after the cessation time is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

103. Where a participating employee disposes of a share acquired as a result of the conversion by exercise of a performance right a capital gain or capital loss may arise (see paragraphs 77 to 80 of this Ruling).

104. Pursuant to subsection 130-60(1) of the ITAA 1997, the first element of the cost base of the share acquired as a result of the conversion by exercise of the performance right will be the cost base of the right at the time of conversion. Pursuant to subsection 130-83(3) of the ITAA 1997, the first element of the cost base of the performance right will be the market value of the right worked out under sections 139FA to 139FF at the cessation time.

Lapse of rights

105. Where a performance right acquired by a participating employee lapses before it is converted by exercise, whether or not a cessation time has occurred (prior to the lapse), section 139DD will apply to deem the right to never have been acquired for the purposes of Division 13A. As a consequence, no amount in relation to that right is included in assessable income under subsection 139B(1).

106. The lapse of a participating employee’s performance right in accordance with the 2005 PRP rules (in conjunction with the DSP) will constitute the ending of an intangible CGT asset (CGT event C2). Thus, pursuant to subsection 104-25(3) of the ITAA 1997, the participating employee may make a capital gain or a capital loss on the lapse of a performance right.

107. However, as the participating employee's lapsed performance right is deemed never to have been acquired for the purposes of Division 13A (pursuant to section 139DD) Subdivision 130-D of the ITAA 1997 has no application and any capital gain or capital loss is determined under Part 3-1 of the ITAA 1997.

108. The first element of the cost base of the performance right will be nil as a participating employee does not provide any consideration for the acquisition of the right. The market value substitution rule has no application, pursuant to Item 5 in the table in subsection 112-20(3) of the ITAA 1997.

109. Whilst a participating employee will not receive any capital proceeds from the lapse of the performance right, the market value substitution rule will not apply as it is accepted that the lapse of the right constitutes an ending by expiry, pursuant to subsection 116-30(3) of the ITAA 1997.

110. As such a participating employee will not make a capital gain or capital loss where a performance right lapses in accordance with the 2005 PRP rules (in conjunction with the DSP).

Appendix 2– Detailed contents list

111. The following is a detailed contents list for this ruling:

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- employee share schemes

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