



# ***CR 2006/54 - Income tax: Shell Group Restructure - Employee Option Plans - discount not assessed at time of restructure***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2004*



## Class Ruling

# Income tax: Shell Group Restructure – Employee Option Plans – discount not assessed at time of restructure

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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 (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and 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

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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 139CA of the ITAA 1936;
  - section 139CB of the ITAA 1936;
  - section 139CC of the ITAA 1936;
  - section 139CD of the ITAA 1936;
  - section 139DQ of the ITAA 1936;
  - section 139DR of the ITAA 1936;
  - section 139E of the ITAA 1936;

- section 139GCC of the ITAA 1936; and
- section 130-83 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

## **Class of entities**

3. The class of entities to which this Ruling applies is all persons who acquired options under an option plan listed in paragraph 15 of this Ruling while they were employed in Australia by either the Shell Company of Australia Limited or Shell Refining (Australia) Pty Ltd. They are persons who immediately prior to the restructure as described in paragraphs 18 to 22 of this Ruling:

- held those options;
- were employed by a company in the Shell group of international companies (the Shell group);
- had not made an election under section 139E in relation to those options; and
- had not had a cessation time happen, within the meaning of section 139CB, in relation to those options.

In this Ruling, a person belonging to this class of entities is referred to as a 'participating employee'.

## **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 23 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.

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## **Date of effect**

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8. This Ruling applies to the income years ended 30 June 2005 and 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).

## Withdrawal

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12. This Ruling is withdrawn on and ceases to have effect after 30 June 2006. The Ruling continues to apply in respect of the relevant provisions ruled upon to all entities within the specified class who entered into the specified scheme during the term of the Ruling. Thus the Ruling continues to apply to those entities, even following its withdrawal, for the scheme entered into prior to the withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

## Scheme

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13. The scheme that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- The request for class ruling (CR1) from Allens Arthur Robinson dated 6 May 2005;
- Annexure A – Background Information;
- Annexure B – The Shell Petroleum Company Limited Stock Option Plan for Employees;
- Annexure C – The Shell Petroleum Company Limited Stock Option Plan (1967);
- The Royal Dutch Petroleum Company Articles of Association;
- Addendum to class ruling application from Allens Arthur Robinson dated 16 December 2005.

14. The Shell group operates a number of employee option and share plans. Participants in these plans include persons employed in Australia by the Shell Company of Australia Limited and Shell Refining (Australia) Pty Ltd.

15. Options (RD options) to acquire shares in the Royal Dutch Petroleum Company (RD), one of two former publicly held foreign parent companies of the Shell group, were acquired by participating employees under one of the following option plans (referred to collectively as 'option plans'):

- The Shell Petroleum Company Limited Stock Option Plan for Employees;
- The Shell Petroleum N.V. Stock Option Plan for Employees;

- The Shell Petroleum Company Limited 1967 Stock Option Plan; and
- The Shell Petroleum N.V. 1967 Stock Option Plan.

16. RD options granted under option plans gave participating employees the right to buy RD Bearer Shares or RD Hague Registered Shares. Participating employees provided no consideration for the RD options and acquired legal title at the time of grant.

17. The applicant has advised that RD options acquired by participating employees under the option plans were qualifying rights within the meaning of section 139CD.

### **Restructure of the Shell group**

18. A major restructure of the Shell group was undertaken to enable the two former publicly held foreign parent companies (RD and the Shell Transport and Trading Company plc (STT)) to be unified (referred to as 'top-hatting') under a single parent company, Royal Dutch Shell plc (RDS).

19. The restructure was subject to shareholder and regulatory approval and was implemented by a combination of:

- a public exchange offer by RDS (the RD offer) (under appropriate Dutch and US laws) for all ordinary shares in RD; and
- a scheme of arrangement (pursuant to the *Companies Act 1985* of England and Wales), between STT, shareholders in STT and bearer warrant holders in STT.

20. The terms of the RD offer and the scheme of arrangement reflected the ownership of the Shell group by RD and STT and sought to ensure that:

- ordinary shareholders in RD and STT; and
- holders of bearer warrants and American depository receipts in STT,

were offered securities in RDS representing the equivalent economic interest in the Shell group following implementation of the top-hatting as their securities represented in the Shell group prior to the restructure.

21. The last condition to the RD offer was satisfied on 20 July 2005 and the restructure proceeded.

22. As a result of the restructure the RD options held by participating employees were rolled over so that when the options are exercised, those participating employees will receive RDS 'A' shares in lieu of RD shares. While participating employees were advised that their RD options would be rolled over in this way they were not asked to consent to that process. Rolled over options (RDS options) will continue to be governed by the appropriate option plan.

23. The applicant has advised that:

- the rollover of RD options was effected using the same ratio as used in the RD offer, so that participating employees maintained the same level of interest in the Shell group after the restructure;
- participating employees were employees of the Shell group after the restructure;
- RDS 'A' shares are ordinary shares; and
- at the time participating employees acquired rolled over RD options, no participating employees held a legal or beneficial interest in more than 5% of the shares in RDS and no participating employee was in a position to cast, or control the casting of, more than 5% of the maximum number of votes that may be cast at a general meeting of RDS.

## Ruling

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24. Where a participating employee acquired an RD option under an option plan they acquired a qualifying right for the purposes of Division 13A of Part III (Division 13A).

25. The discount received in relation to the RD option is included in the assessable income of the participating employee in the year that a cessation time happens in relation to the replacement RDS option.

26. The acquisition by a participating employee of a right to acquire a share in RDS as a consequence of the restructure is regarded as the acquisition of a matching right and the right is treated as if it was a continuation of the right to acquire an RD share for the purposes of Division 13A. Thus, this event did not trigger a cessation time.

27. For capital gains tax (CGT) purposes, any capital gain or capital loss that arises from the rollover of an RD option under the restructure is disregarded, in accordance with subsection 130-83(1A) of the ITAA 1997.

## Appendix 1 – Explanation

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**❶** *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.*

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

29. For the purposes of this Ruling, the Commissioner accepts the statement by the applicant that options acquired under the options plans are qualifying rights for the purposes of section 139CD. Thus, a participating employee will have acquired a qualifying right when an RD option was granted to the participating employee under one of the option plans.

30. Where an employee acquires a share or right under an employee share scheme the discount given in relation to the share or right is included in the assessable income of the employee, pursuant to subsection 139B(1).

31. Where an employee acquires a qualifying right and does not make an election under section 139E, the discount given in relation to the right is included in assessable income in the year of income in which the cessation time occurs, in accordance with subsection 139B(3).

32. The cessation time is determined in accordance with subsection 139CB(1). Because a share acquired by a participating employee as a result of exercising an RD option is not subject to disposal restrictions, the cessation time will be the earlier of:

- the time when the participating employee disposes of the option (other than by exercising it);
- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2);
- the time when the participating employee exercises the option; and
- the end of the 10 year period starting when the participating employee acquired the option.

33. The amount of the discount to be included in an 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 an arm's length transaction within 30 days of the cessation time.

34. As a result of the restructure of the Shell group RD options acquired under one of the option plans and held by participating employees were 'rolled over' with the effect that when participating employees exercise those options they will receive RDS 'A' shares.

## **'Disposal' of RD options**

35. Implicit in the application and operation of Division 13A, is the notion that the reference to (a contract in the form of) a right is not just a right, it must be a right to acquire a share or it will not qualify as a right for the purposes of Division 13A. The terms and conditions attaching to such a right may vary but the primary object of that right must be a share.

36. Under an option plan a participating employee acquired a right to acquire a share in RD (RD option). As a result of the restructure a participating employee no longer holds an option to acquire a share in RD and can no longer enforce that original right to acquire a share in RD. The rollover of the RD options is considered to be more than a mere change to the terms and conditions of the original option contract, it is a substantial and complete change of the underlying security (a share) that can be acquired under the contract by exercise. A participating employee no longer holds an option to acquire a share in RD as that option has been substituted or replaced by an option to acquire a share in RDS. Accordingly, it is considered that this arrangement in effect amounts to a disposal of the original RD option.

## **'Rollover provisions'**

37. Subdivision DA of Division 13A which came into effect from 1 April 2005, was implemented to provide relief from the possible early application of the provisions of sections 139CA or 139CB (determination of a cessation time) in the event of a corporate takeover or restructure occurring on or after 1 July 2004.

38. If these provisions are applicable, RDS options acquired by a participating employee under the restructure are treated as if they are a continuation of the RD options and the restructure does not trigger an early cessation time.

## **The effect of a restructure on an employee share scheme**

39. The rollover provisions are intended to apply to certain types of takeovers and restructures and in that regard section 139GCC defines the meaning of restructure for the purposes of this provision. A restructure of a company is a change in the ownership of the company, or the structure of the ownership of the company as a result of which some or all shares or rights held in the company under an employee share scheme immediately before the change are replaced, or could reasonably be regarded as having been replaced, wholly or partly by shares or rights in one or more other companies. It is accepted that the Shell group restructure satisfies this definition and is a restructure within the meaning of section 139GCC.

40. Section 139DQ sets out in the first instant the circumstances that the provision will apply to. In this case the relevant requirements are that:

- a) an employee acquires a right in a new company;
- b) that right can reasonably be regarded as matching a right in another company (the old company);
- c) the right in the old company was acquired under an employee share scheme;
- d) the acquisition of the right in the new company occurs in connection with a restructure of the old company; and
- e) as a result of the restructure the employee ceased to hold rights in the old company.

41. For the purposes of a) above, a participating employee in an option plan who held an RD option prior to the restructure, is considered to have acquired a right in a new company as a result of the restructure proceeding and the RD options being rolled over into RDS options.

42. For the purposes of b) above, the note to subsection 139DQ(1) provides a guide as to a factor that is relevant in determining to what extent something can reasonably be regarded as matching a right in the old company. That is, the respective market values of the old rights and the new rights. The Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004 that introduced the rollover provisions, provides further guidance on this issue when it states:

Matching shares or rights should be no more than that which is required to place the employee in the same position financially as if the restructure had not occurred.

43. The applicant has advised that the rollover of RD options was effected using the same ratio as used in the RD offer so that participating employees maintained the same level of interest in the Shell group after the restructure. Further, the applicant has advised that the RD options (being qualifying rights) were acquired under an employee share scheme as defined. Thus, it is accepted that the restructure meets the requirements as set out in subparagraph 139DQ(1)(a)(ii).

44. Lastly, it is accepted that when a participating employee acquired an option in RDS (the new company) as a result of the restructure, they ceased to hold an option in RD (the old company) as the option to acquire a share in RD no longer exists.

45. Section 139DQ also provides that the treatment of matching rights as a continuation of rights in the old company is subject to the conditions in section 139DR.

## Conditions for continuation of rights

46. Section 139DR sets out the following conditions that must be met before the matching rights will be treated (for the purposes of Division 13A) as being a continuation of rights to acquire shares in the old company:

- 1) the employee must have held rights in the old company under an employee share scheme immediately before the restructure;
- 2) where the employee has not made an election under section 139E in relation to rights in the old company, the employee, at or about the time they acquired the matching rights must be employed by the new company, a holding company of the new company or a subsidiary of either the new company or a holding company of the new company;
- 3) the matching rights must be rights to acquire ordinary shares; and
- 4) at the time of acquiring the matching rights the employee:
  - a. must not hold a legal or beneficial interest in more than 5% of the shares of the new company; and
  - b. not be in a position to cast or control more than 5% of the votes at a general meeting of the new company.

47. To determine whether conditions 1), 2) and 3) above are satisfied, is ordinarily a matter of fact.

48. In accordance with the class of entities as described in paragraph 3 of this Ruling, this Ruling only applies to participating employees who acquired options under option plans and held those options immediately prior to the restructure. Therefore it is accepted that the first condition is met.

49. The applicant has advised that participating employees were employees of the Shell group after the restructure (that is, they were employees of RDS or a subsidiary of RDS). Therefore, as participating employees have not made elections under section 139E in relation to their RD options at the time of the restructure, it is accepted that the second condition is satisfied.

50. The applicant has also advised that RDS 'A' shares are ordinary shares, therefore it is accepted that the third condition is satisfied.

51. In relation to the fourth condition, the applicant has advised that at the time participating employees rolled over their RD options (that is, acquired matching rights) no participating employees held a legal or beneficial interest in more than 5% of the shares of RDS or were in a position to cast or control more than 5% of the votes at a general meeting of RDS. Thus, this condition is also satisfied.

52. In summary, it is accepted that the circumstances described in section 139DQ were present and the conditions set out in section 139DR were met. Therefore the acquisition by a participating employee of an RDS option as a consequence of the restructure is treated as if it was a continuation of the RD option for the purposes of Division 13A.

### **Capital gains tax**

53. Subdivision 130-D of the ITAA 1997 which deals with the CGT implications for taxpayers involved in employee share schemes as defined in Division 13A, was amended to complement the new rollover provisions in Subdivision DA of Division 13A which came into effect from 1 April 2005. These amendments apply to acquisitions of shares or rights on or after 1 July 2004.

54. Subsection 130-83(1A) of the ITAA 1997 provides that if a CGT event happens in relation to a right (for example a disposal) and it happens in connection with an acquisition of another right that under section 139DQ is treated for the purposes of Division 13A as if it was a continuation of the original right, then any capital gain or capital loss from the CGT event is disregarded.

55. Where a participating employee held an RD option immediately before the restructure and as a result of the restructure acquired an RDS option, then in accordance with paragraphs 37 and 38 the RDS option is treated as if it was a continuation of the RD option for the purposes of Division 13A.

56. Therefore, for the purposes of subsection 130-83(1A) of the ITAA 1997, when the restructure happened a CGT event (a disposal) happened in relation to the RD option:

- that CGT event happened in connection with the acquisition of the RDS option; and
- under section 139DQ the RDS option was treated for the purposes of Division 13A as if it was a continuation of the RD option,

therefore, any capital gain or capital loss from the CGT event is disregarded.

## **Appendix 2 – Detailed contents list**

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57. The following is a detailed contents list for this Ruling:

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

CR 2006/53; CR 2006/55;  
CR 2006/56

*Subject references:*

- capital gains tax
- election
- employee share scheme
- no election
- options
- restructure

*Legislative references*

- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B
- ITAA 1936 139B(1)
- ITAA 1936 139B(3)
- ITAA 1936 139CA
- ITAA 1936 139CB
- ITAA 1936 139CB(1)
- ITAA 1936 139CB(2)

- ITAA 1936 139CC
- ITAA 1936 139CD
- ITAA 1936 Pt III Div 13A Subdiv DA
- ITAA 1936 139DQ
- ITAA 1936 139DQ(1)
- ITAA 1936 139DQ(1)(a)(ii)
- ITAA 1936 139DR
- ITAA 1936 139E
- ITAA 1936 139G
- ITAA 1936 139GCC
- ITAA 1997 Subdiv 130-D
- ITAA 1997 130-83
- ITAA 1997 130-83(1A)
- Copyright Act 1968
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Companies Act 1985 (UK)

*Other references:*

- Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004

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ATO references

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