


CR 2008/81 - Income tax: Peplin Group Restructure - Employee Share Scheme - treatment of unlisted options

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Class Ruling

Income tax: Peplin Group Restructure – Employee Share Scheme – treatment of unlisted options

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① 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 provision dealt with in this Ruling is:

- Division 13A of Part III (Division 13A) of the *Income Tax Assessment Act 1936* (ITAA 1936).

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 were employees of Peplin Ltd or any of its wholly owned subsidiaries (the Peplin group):

- who were issued unlisted options in Peplin Ltd (unlisted options) under the Employee Share Option Plan, the Directors and Officer's Plan or any other arrangements (as described in paragraph 12 of this Ruling); and
- who held the unlisted options at the time of the implementation of the restructure (as described in paragraphs 15 to 18 of this Ruling).

In this Ruling, a person belonging to this class of entities is referred to as a participant.

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 9 to 20 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

8. This Ruling applies to the income year ended 30 June 2008. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description of the scheme:

- application for Class Ruling from PricewaterhouseCoopers (the applicant) dated 30 July 2007;
- Information Memorandum for recommended schemes of arrangement;
- Restructure Implementation Agreement; and
- correspondence and emails received in relation to the application for a Class Ruling.

10. Prior to the restructure described in paragraphs 15 to 18 of the Ruling, Peplin Ltd was a listed company on the Australian Securities Exchange and was the head company of the Peplin group.

11. The Peplin group operated the following employee share schemes:

- the Employee Share Option Plan; and
- the Directors & Officers Plan;

under which unlisted options were issued to participants.

12. Unlisted options were also issued to certain participants as a sign on bonus or to top up existing holdings of unlisted options in accord with a new Peplin Ltd policy.

13. Participants were not required to provide consideration for unlisted options issued to them.

14. The applicant has advised that the unlisted options issued to participants were qualifying rights for the purposes of Division 13A.

The restructure

15. The Peplin group undertook a corporate restructure on 16 October 2007 that resulted in the establishment of a new parent company of the Peplin group. The new company was incorporated in the United States and is referred to in this Ruling as Peplin US.

16. The restructure was implemented through two separate Court sanctioned schemes of arrangement under the *Corporations Act 2001*, one involving shareholders and the other involving holders of listed options.

17. The applicant has advised that a key objective of the restructure was to place all current shareholders and option holders in substantially the same financial position immediately after the restructure as they were immediately prior to the restructure.

18. As part of the restructure, all unlisted options in Peplin Ltd held by participants, which were not covered by the schemes of arrangement:

- were cancelled; and
- the participants were issued with replacement options (new options) to acquire common stock in Peplin US under a Stock Option Plan (new plan) adopted by Peplin US.

19. The applicant has advised that immediately following the restructure:

- the employment of employees within the Peplin group remained unchanged;
 - a shareholder received one share of common stock in Peplin US for every 20 shares held in Peplin Ltd; and
 - each new option in Peplin US, issued to a participant:
 - had an exercise price per option equal to 20 times the exercise price (per option) of the unlisted option it replaced;
 - had an exercise period equal to the unexpired exercise period of the unlisted option it replaced;
 - was vested to the same extent and had the same terms including the vesting schedules as the unlisted option it replaced;
 - otherwise issued on the terms of the new plan;
- and that subsequent to the restructure:
- no preferred stock in Peplin US have been issued.

20. The applicant has also advised that at the time of issue of new options to participants:

- no participant held a legal or beneficial interest in more than 5% of the shares in Peplin US; or
- 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 Peplin US.

Ruling

21. Where under the restructure, a participant was issued with new options in Peplin US, the new options will be treated, for the purposes of Division 13A, as if they are a continuation of the unlisted options in Peplin Ltd.

Commissioner of Taxation

26 November 2008

Appendix 1 – Explanation

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.*

Acquisition of right

22. 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.

23. For the purposes of this Ruling, the Commissioner accepts the advice by the applicant that unlisted options issued to participants are qualifying rights for the purposes of Division 13A.

24. Where a participant acquires a right under an employee share scheme the discount given in relation to the right is included in the assessable income of the participant.

25. Where a participant 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).

Takeovers and restructures

26. The object of Subdivision DA of Division 13A is to allow Division 13A to continue to apply, in appropriate circumstances, to shares or rights acquired under an employee share scheme where a 100% takeover or restructure is involved.

27. If Subdivision DA of Division 13A is applicable, new options issued to a participant under the restructure will be treated as if they are a continuation of unlisted options and the restructure will not trigger a cessation time for unlisted options held by a participant who has not made a section 139E election.

The effect of a restructure on an employee share scheme

28. 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, 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.

29. It is accepted that the Peplin group restructure satisfies this definition and was a restructure within the meaning of section 139GCC.

30. 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) the 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.

31. For the purposes of subparagraph 30(a) of this Ruling, a participant, who held an unlisted option prior to the restructure, acquired a right in Peplin US (the new company).

32. For the purposes of subparagraph 30(b) of this Ruling, in determining whether a right can reasonably be regarded as matching a right in another company, the note to subsection 139DQ(1) provides that one of the factors to consider is the respective market values of the old shares and the new shares. The Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004 (the EM) that introduced the provisions provides further guidance on this issue when it states at paragraph 3.14:

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.

Further, in paragraph 3.19 of the EM it states that:

The attributes of the shares or rights immediately before the restructure need to be the same, or substantially the same, immediately after the restructure.

33. The applicant has advised that a key objective of the restructure was to place all current shareholders and option holders in substantially the same financial position immediately after the restructure as they were immediately prior to the restructure. Further, the applicant has also advised that the exercise price (as appropriately adjusted) and period, and the vesting terms and conditions for a new option to acquire a share in Peplin US were essentially the same as for an unlisted option to acquire a share in Peplin Ltd.

34. Based on this advice, the Commissioner accepts that new options in Peplin US (the new company) are regarded as matching unlisted options in Peplin Ltd (the old company).

35. The applicant has advised that unlisted options in Peplin Ltd (the old company) issued to participants are qualifying rights for the purposes of Division 13A. To be a qualifying right, in accordance with subsection 139CD(2), a right must have been acquired under an employee share scheme (as defined). Therefore, it is accepted that the requirement in subparagraph 30(c) of this Ruling is satisfied.

36. For the purposes of the requirements in subparagraphs 30(d) and (e) of this Ruling, it is accepted that the acquisition by a participant of a new option in Peplin US (the new company) occurred in connection with the restructure of Peplin Ltd (the old company). As a result of that restructure the participant ceased to hold an unlisted option in Peplin Ltd (the old company) as the unlisted option was cancelled when the restructure was implemented.

37. Having met the above requirements, section 139DQ also provides that the treatment of matching rights as a continuation of existing rights is also subject to the conditions in section 139DR.

Conditions for the continuation of rights

38. Section 139DR sets out the following conditions that must be met before the treatment of a new right as being a continuation of an old right in section 139DQ will have effect:

- (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.

39. An employee is considered to hold rights under an employee share scheme for the purposes of subsection 139DR(1), where:

- such rights were acquired under an employee share scheme;
- at the time of the restructure such rights are unexercised; and

- the rights are potentially subject to relief by the operation of section 139DD (no benefit where rights lost) if the rights lapse or are lost before being exercised.

40. In accordance with the class of entities (as described in paragraph 3 of this Ruling) participants are persons who were issued rights (unlisted options) under an employee share scheme and who held those (unexercised) rights at the time of the implementation of the restructure. Further, but for the restructure, if the unlisted options in Peplin Ltd were to lapse or be lost before being exercised section 139DD can apply. Therefore, it is accepted that the first condition is satisfied.

41. For the purposes of the second condition, the applicant has advised that as part of the restructure the employment of employees within the Peplin group remained unchanged. Therefore, for those participants who have not made an election under section 139E in relation to the year that the unlisted options were acquired, it is accepted that the second condition is satisfied. The second condition does not apply to those participants who have made a section 139E election.

42. As to the third condition, the applicant has advised that the issue of new options to participants under the new plan entitled them to acquire shares of common stock in Peplin US. The Commissioner accepts that a share of common stock in Peplin US is an ordinary share for the purposes of Division 13A.

43. In relation to the last of the conditions, the applicant has advised that at the time of the restructure, when new options in Peplin US were issued to participants, no participant held a legal or beneficial interest in more than 5% of the shares of Peplin US or was in a position to cast or control the casting of, more than 5% of the maximum number of the votes that may be cast at a general meeting of Peplin US.

44. In summary, it is accepted that in relation to the restructure, the circumstances described in section 139DQ were present and the conditions set out in section 139DR were met. Therefore, new options in Peplin US issued to a participant as a consequence of the restructure will be treated as if they are a continuation of unlisted options in Peplin Ltd for the purposes of Division 13A.

45. **Note:** the applicant has advised that unlisted options in Peplin Ltd have also been issued to certain service providers. Where such holders of unlisted options received replacement options in Peplin US as part of the restructure, the replacement options will not be treated as continuing rights for the purposes of Division 13A. As a consequence they are not included in the class of entities covered by this Ruling. These unlisted options holders should refer to the Class Ruling dealing with the capital gains tax scrip for scrip roll-over for shareholders and option holders of Peplin Ltd.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- employee share scheme
- election
- options
- qualifying rights
- restructure

Legislative references:

- ITAA 1936
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B(3)
- ITAA 1936 139CD(2)
- ITAA 1936 139DD

- ITAA 1936 Pt III Div 13A Subdiv DA
- ITAA 1936 139DQ
- ITAA 1936 139DQ(1)
- ITAA 1936 139DR
- ITAA 1936 139DR(1)
- ITAA 1936 139E
- ITAA 1936 139G
- ITAA 1936 139GCC
- Copyright Act 1968
- Corporations Act 2001
- TAA 1953

Other references:

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

ATO references

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