# *CR 2013/15 - Income tax: Leighton Holdings Limited Equity Incentive Plan*

# Class Ruling

## Income tax: Leighton Holdings Limited Equity Incentive Plan

Contents Para





## 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 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 15-2 of the ITAA 1997;
- Subdivision 83A-C of the ITAA 1977;
- section 83A-120 of the ITAA 1997;
- section 83A-330 of the ITAA 1997
- section 83A-340 of the ITAA 1997; and
- Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936)

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

### Class of entities

3. The class of entities to which this Ruling applies are employees of Leighton Holdings Limited (Leighton) or wholly owned subsidiaries of the Leighton Holdings Limited Group of companies (Group) who:

- acquired awards under the Leighton Equity Incentive Plan (the Plan); and
- are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936.

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 arrangement 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 33 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- this Ruling may be withdrawn or modified.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 1 January 2012. 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:

- Class ruling application dated 7 September 2012;
- Trust Deed for Leighton Equity Incentive Plan (Deed) dated 9 February 2012;
- Leighton Holdings Equity Incentive Plan Administration Rules (Plan) adopted 22 May 2012; and
- Communications with the applicant

10. Leighton is, as at the date of this Ruling, the parent entity of the following wholly owned subsidiaries:

- Leighton Admin Services Limited
- Thiess Pty Ltd
- Leighton Contractors Pty Ltd
- John Holland Group Pty Ltd
- Leighton Properties Pty Ltd

### The Plan

11. The Plan is an employee equity plan established by Leighton after obtaining approval from shareholders at the Leighton group's AGM on 22 May 2012.

12. Leighton also established an employee share trust (Trust) with CPU Share Plans Pty Ltd appointed as the trustee (Trustee). The Trustee is not a related party of Leighton nor is it a subsidiary of the Group. The Trust was established :

- to assist Leighton with capital management for the Plan
- to more easily facilitate a forfeited right (Right) to acquire a Leighton share (Share); and

- to facilitate the acquisition of new issues or market purchased shares to satisfy Rights granted under the Plan.

13. The Deed allows the Trustee to acquire, hold, allocate and transfer Shares to Participants of the Plan.

14. Leighton currently intends to grant three types of awards under the Plan as follows:

- Long-term incentive (LTI) awards
- Short-term incentive deferral (STI deferral) awards; and
- One-off awards (One-off awards)

15. The awards are granted to eligible employees (both Australian resident and foreign resident employees) of the Group for no consideration.

16. An award granted to a Participant under the Plan is a right to acquire a Leighton share or, at the discretion of the Leighton Board (Board), receive a cash payment in lieu thereof, subject to the Participant satisfying continuing employment (service condition) with Leighton and, where applicable, performance conditions as determined by the Board.

17. Where the specified vesting conditions are met, Rights vest and Rights may be settled in Shares, or cash of equivalent value, at the discretion of the Board. The Board will generally determine whether to settle Rights in cash or Shares immediately prior to vesting of the Rights. Participants are not required to pay any consideration on vesting of the Rights.

18. Leighton currently intends to exercise its discretion to make cash payments in certain cases for Participants based outside Australia or to simplify the operation of the Plan in relation to Rights held by Participants who cease employment under the good leaver circumstances.

19. Where Rights are satisfied with Shares, no disposal restriction will apply to the Shares allocated on vesting of the Rights and Participants acquiring Shares can dispose of them at any time, subject to the Group's securities trading policy.

20. Participants are not entitled to any dividend or voting rights during the vesting / performance period.

21. Immediately after acquisition of the Rights, none of the Participants will hold a beneficial interest in more than 5% of the Shares and are not in a position to cast or control the casting of more than 5% of the votes that may be cast at a general meeting of Leighton.

22. The predominant business of Leighton is not the acquisition, sale or holding of shares, securities or other investments (whether directly or indirectly through one or more companies, partnerships or trusts).

### *Vesting conditions for STI deferral/One-off awards*

23. Participants granted with STI deferral and One-off awards are required to remain an employee of the Group through to the vesting date. The vesting date for STI deferral will generally be 2 years after the grant of Rights. The vesting for One-off awards will depend on the specific vesting period determined for the relevant Participant but normally range from 1 year to 3 years after the grant of Rights.

24. If a Participant ceases employment with the Group prior to vesting, their Rights will lapse. Where a Participant ceases employment under the good leaver circumstances, the participant will be entitled to retain their unvested Rights which will then vest at the end of the original vesting period.

25. Participants holding STI deferral or One-off awards are entitled to receive notional accrued dividends at vesting representing the dividends the Participants would have received had they held Shares during the service period; i.e., to the extent Rights vest, at vesting the Participant will receive an additional amount (delivered as a separate cash payment) in respect of the dividends that would have been paid on the vested Shares during the relevant service/vesting period.

26. The cash payment in lieu of notional accrued dividends may be made in one of two ways (Leighton wishes to retain flexibility as to how the payment is funded):

(i) A cash payment will be made to the Participant by the Participant's employing entity, through the payroll on the next available pay run following vesting (Notional Dividend payment method A); or

(ii) The Trustee of the employee share trust acquires Shares in relation to Rights granted on STI deferral/One-off awards and holds the Shares until vesting as unallocated Trust property. The Trustee will include any dividends received on such Shares (whilst they are unallocated Trust property) as assessable income subject to tax under section 99A of the ITAA 1936. At vesting, the net cash held by the Trust in relation to those dividends (after meeting the related tax liability) will be distributed to Participants in lieu of the accrued dividends (Notional Dividends payment method B).

### *LTI award*

27. The vesting date for LTI awards will generally be 3 years after the grant of the Rights. Vesting is subject to the satisfaction of continued employment and performance conditions.

28. Where performance conditions apply, the LTI awards are divided into two parcels, with a separate performance condition applying to each parcel. The performance conditions that need to be satisfied are:

(i) Relative Total Shareholder Return (TSR); and

(ii) Absolute Earnings Per Share (EPS).

29. Upon satisfaction of the service condition and the performance conditions (where applicable), the Rights will vest.

30. If a Participant ceases employment prior to vesting due to resignation, termination for cause or any other circumstances determined by the relevant committee, the Rights granted as LTI awards will be forfeited. If a Participant ceases employment under the good leaver provisions, the Participant will be entitled to retain a pro-rata amount of their unvested Rights.

### Vesting of Rights under the Plan

31. When the Rights granted under the Plan vest, a participant will receive the relevant number of Shares from the trustee of the employee share trust, unless the decision to cash-settle Rights has been made.

32. Under the terms of the Plan, no disposal restrictions will apply to the Shares allocated on vesting of the Rights and the Participants acquiring the Shares can dispose of them at any time, subject to the Group's securities trading policy.

33. When the Board determines to settle the Rights in cash, the amount of the cash payment will be determined based on Leighton's share price on the relevant vesting date.

## Ruling

### Where Rights are settled with shares

34. Rights acquired under the Plan are indeterminate rights for the purposes of section 83A-340. If the Board does not exercise its discretion to satisfy the Rights with a cash payment, the indeterminate rights will be treated as rights to acquire a beneficial interest in Shares from the time the Rights were acquired by the Participants.

35. The rights to acquire a beneficial interest in Shares are ESS interests acquired under an employee share scheme.

### Subdivision 83A-C

36. Rights acquired by Participants under the Plan are at real risk of forfeiture and where section 83A-340 applies to the Rights, Subdivision 83A-C also applies to the Rights.

37. An amount in relation to the Rights will be assessable in the income year in which the earliest ESS deferred taxing point occurs as determined under section 83A-120.

### Where Rights are satisfied in cash

38. Where a Participant's Rights are satisfied in cash, including where a Participant has ceased employment (within the meaning of section 83A-330), the cash payment will be included in the assessable income of the Participant in the year in which it is received under section 6-5.

### Where a Participant receives a notional accrued dividend

39. The distribution of a notional dividend to a Participant under Notional Dividend payment method A will be included in the Participant's assessable income under section 6-5.

40. The distribution of a notional dividend to a Participant under Notional Dividend payment method B will not be assessable to the Participant under Division 6 of Part III of the ITAA 1936, or under section 6-5. Nor will it be assessable to the Participant under section 15-2.

**Commissioner of Taxation**
27 February 2013

# 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.***

### Where Rights are settled with Shares

#### *ESS interests*

41. For the purposes of Division 83A, an ESS interest in a company is defined under subsection 83A-10(1) as either a beneficial interest in a share in the company or a beneficial interest in a right to acquire a beneficial interest in a share in the company.

42. Under the Plan, Participants are granted Rights to acquire Shares for no consideration, subject to a Service Condition and, where applicable, a Performance Condition. Upon satisfaction of these condition(s), the Rights will vest.

43. However, the Board retains a discretion to determine that the Participant's entitlement at any time before vesting will be satisfied with a cash payment in lieu of Shares. For as long as the Board retains the discretion, the Right will not yet be a right to acquire a beneficial interest in a Share.

#### *Indeterminate rights*

44. Section 83A-340 provides that where an employee acquires a beneficial interest in a right that later becomes a right to acquire a beneficial interest in a share, Division 83A will apply as if the right had always been a right to acquire the beneficial interest in the share.

45. In order for section 83A-340 to apply, the right must be capable of becoming a right to acquire a beneficial interest in a share and in fact become such a right.

46. Section 83A-340 provides examples of such rights which illustrate that a right to acquire an indeterminate number of shares, or a right to ESS interests or cash at the provider's discretion, are rights capable of becoming rights to acquire a beneficial interest in shares. Therefore, if the Board does not exercise its discretion to satisfy the rights with cash, section 83A-340 will apply to the Rights. Division 83A will then apply to the Rights as if the Rights had always been a right to acquire a beneficial interest in Shares.

47. The Rights will be ESS interests acquired under an employee share scheme under section 83A-10 as the Rights are granted to a Participant in relation to their employment as an employee of a company in the Group.

48. As the Rights are awarded to employees for no consideration under the Plan, the Rights will be acquired at a discount.

### Subdivision 83A-C

***Real risk of forfeiture***

49. Subsection 83A-25(1) in Subdivision 83A-B requires that assessable income for the income year in which the ESS interest is acquired includes the discount in relation to the interest. However, Subdivision 83A-B will not apply if Subdivision 83A-C applies.

50. Subdivision 83A-C provides that where certain conditions are satisfied, the discount in relation to a beneficial interest in a right to acquire a beneficial interest in a share is not included in an employee's assessable income when they acquire the interest. Instead, under section 83A-110 the assessable income of the employee will include at a later time, the market value of the interest at the ESS deferred taxing point reduced by the cost base of the interest. The conditions to be satisfied for the interest to be eligible for an ESS deferred taxing point are listed at subsection 83A-105(1).

51. The first condition is that Subdivision 83A-B would, but for section 83A-105, have applied to the interest.

52. The second condition is that the interest be an interest in the company that employed the employee, or the holding company of that company.

53. The third condition is that all interests available under the employee share scheme must relate to ordinary shares.

54. The fourth condition is that:

- the predominant business of the company in which the interests are acquired is not the acquisition, sale or holding of shares, securities or other investments (directly or indirectly); or if it is
- the employee is not employed by that company and also a subsidiary of that company or a holding company of that company, or a subsidiary of the holding company.

55. The fifth condition is that immediately after the interest is acquired the employee will not hold a beneficial interest in greater than 5% of the shares, or be in a position to control the casting of greater than 5% of the votes that might be cast at a general meeting of the company.

56. The Commissioner accepts for the purposes of Subdivision 83A-C, that in relation to Rights acquired by a Participant under the Plan, the first five conditions have been satisfied.

57. The sixth and final condition that must be satisfied is that there must be a real risk, under the scheme rules, that the Participant:

- will forfeit or lose the ESS interest (other than by disposing of it, exercising the right or letting the right lapse); or

- if the right is exercised, the Participant will forfeit or lose the beneficial interest in the share (other than by disposing of it).

58. In order for the 'real risk of forfeiture' test to be satisfied, in relation to an ESS interest acquired by an employee under an employee share scheme, a reasonable person must consider that there is an actual possibility of forfeiture. Furthermore the risk of forfeiture must be 'real', not nominal, artificial or contrived. There must be more than a mere possibility.

59. 'Real risk of forfeiture' in a scheme may include conditions where retention of the ESS interests is subject to performance hurdles or a minimum term of employment. In cases where an employee share scheme has both employment and performance conditions to be met, and one of these conditions satisfies the 'real risk of forfeiture' test, it is not necessary to consider whether the other condition also satisfies the test.

60. Where there is some doubt whether a condition will satisfy the 'real risk of forfeiture' test then the other condition will also be examined.

61. Unvested Rights may be forfeited if the Participant ceases employment with the Group during the vesting period. Rights can only vest and be exercised if the service condition and, where applicable, a performance condition, have been achieved by the vesting date. The Rights will lapse to the extent that the service condition and any applicable performance condition are not achieved.

62. As the minimum employment period before vesting is at least 12 months from the grant date, then subject to the discussion below regarding the discretion of the Board, the Commissioner accepts that the 'real risk of forfeiture' test is met for Rights granted under the Plan.

63. In circumstances where a Participant ceases employment for reasons other than death, total and permanent disablement, retrenchment or separation, the Board may exercise its discretion to allow the Participant to retain their unvested Rights. The Commissioner accepts that the availability of the discretion in such circumstances will not prevent the Rights from being at real risk of forfeiture, provided that the discretion is not routinely exercised. Furthermore, employees must not routinely receive the interests regardless of their reason for ceasing employment.

64. Therefore, as there is a real risk that a Participant will forfeit or lose their Rights, other than by disposing of them, the sixth condition is satisfied. Subsection 83A-105(3) will apply to the Rights acquired by a Participant under the Plan.

65. As a result, Subdivision 83A-C applies to the Rights, and Subdivision 83A-B does not apply. The taxation of Rights received under the Plan will be deferred until an ESS deferred taxing point occurs.

### *ESS deferred taxing point*

66. As Subdivision 83A-C applies to the Rights granted under the Plan, section 83A-120 will apply in determining the ESS deferred taxing point.

67. Section 83A-120 provides that the ESS deferred taxing point for rights to acquire shares occurs at the earliest of the following times:

- when the right has not been exercised, there is no real risk of forfeiting the right, and the scheme no longer genuinely restricts disposal of the right (subsection 83A-120(4));
- when the participant ceases the employment in respect of which they acquired the rights within the meaning of section 83A-330 (subsection 83A-120(5));
- seven years after the participant acquired the rights (subsection 83A-120(6)); and
- when there is no real risk of forfeiting the right or underlying share, and the scheme no longer genuinely restricts exercise of the right or disposal of the resulting share (subsection 83A-120(7)).

68. However, if the Participant disposes of the rights (or the shares acquired on exercise of the Rights) within 30 days of the time which would otherwise be the ESS deferred taxing point, the ESS deferred taxing point will instead be the time of disposal (subsection 83A-120(3)).

### *Amount included in assessable income*

69. In accordance with section 83A-110, the amount to be included in assessable income in the income year in which the ESS deferred taxing point occurs will be the market value of the ESS interest at the ESS deferred taxing point reduced by the cost base of the ESS interest.

### *Participant ceasing employment*

70. Where a Participant ceases employment (within the meaning of that term in section 83A-330) with the Group prior to the vesting date and retains their Rights which are subsequently settled in Shares, the Participant will include the discount on their Rights in their assessable income for the year in which they ceased employment, subject to the 30 days rule in subsection 83A-120(3).

71. Where the date of cessation of employment occurs in an income tax year prior to the year in which the rights vest, the employee may need to lodge an amended income tax return to include an amount under subsection 83A-110(1) in their assessable income.

### Where Rights are satisfied in cash

72. Where a Participant's Rights are satisfied in cash upon exercise, including where a Participant ceases employment (within the meaning of section 83A-330) as a good leaver or otherwise, section 83A-340 will not apply to the Rights. The Rights will not be considered as ESS interests under subsection 83A-10(1) and Division 83A will not apply to the Rights.

73. Where a Participant's Rights are ultimately satisfied in cash instead of Shares, the granting of the Rights:

- will be viewed as one of a series of steps in the payment of salary or wages; and
- will not be viewed as a separate benefit to the payment of salary or wages which are excluded from the definition of fringe benefit by paragraph 136(1)(f) of the *Fringe Benefits Tax Assessment Act 1986*.

74. Subsection 6-5(2) provides that the assessable income of an Australian resident taxpayer includes ordinary income derived directly or indirectly from all sources during the income year. Ordinary income includes salary and wages.

75. Therefore, the Participant will need to include the cash payment in their assessable income for the year in which the cash is received under subsection 6-5(2).

### Where a Participant receives a notional accrued dividend

76. The distribution of a notional dividend to a Participant by an employing entity under Notional Dividend payment method A will be included in the Participant's assessable income under section 6-5. Section 6-5 includes in assessable income all income derived directly or indirectly from all sources during the income year. The Participant has received an amount that is revenue in nature from their employing entity, and this amount will be included in the Participants ordinary income.

77. The distribution of a notional dividend to a Participant by the Trustee under Notional Dividend payment method B will not be assessable to the Participant under Division 6 of Part III of the ITAA 1936, or under section 6-5. Nor will it be assessable to the Participant under section 15-2.

# Appendix 2 – Detailed contents list

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

## References

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- employee share schemes

*Legislative references:*

- ITAA 1936 6(1)
- ITAA 1936 Div 6 of Part III
- ITAA 1997 6-5
- ITAA 1997 6-5(2)
- ITAA 1997 15-2
- ITAA 1997 Div 83A
- ITAA 1997 83A-10
- ITAA 1997 83A-10(1)
- ITAA 1997 Subdiv 83A-B
- ITAA 1997 83A-25(1)
- ITAA 1997 Subdiv 83A-C
- ITAA 1997 83A-105(1)
- ITAA 1997 83A-105(3)
- ITAA 1997 83A-110
- ITAA 1997 83A-110(1)
- ITAA 1997 83A-120
- ITAA 1997 83A-120(3)
- ITAA 1997 83A-120(4)
- ITAA 1997 83A-120(5)
- ITAA 1997 83A-120(6)
- ITAA 1997 83A-120(7)
- ITAA 1997 83A-330
- ITAA 1997 83A-340
- FBTAA 1986 136(1)(f)

*Other references:*

- Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

ATO references

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