

# ***CR 2013/6 - Income tax: Aquila Resources Limited Long Term Incentive Plan***

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *23 January 2013*



## Class Ruling

### Income tax: Aquila Resources Limited Long Term Incentive Plan

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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, 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

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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:

- Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 83A-10 of the ITAA 1997;
- section 83A-110 of the ITAA 1997;
- section 83A-120 of the ITAA 1997;
- section 83A-125 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- section 112-15 of the ITAA 1997.

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

## **Class of entities**

3. The class of entities to which this Ruling applies is employees of Aquila Resources Limited (Aquila) or any of its subsidiaries who:

- receive incentives in the form of Performance Rights and/or Share Appreciation Rights (Rights) under the Aquila Resources Limited Long Term Incentive Plan (the Plan) or direct that such Rights be acquired by their nominee;
- are residents of Australia within the meaning of that expression in section 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- are not 'temporary residents' within the meaning of that expression in section 995-1(1) of the ITAA 1997.

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 29 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 from 1 July 2012 to 30 June 2016. The Ruling continues to apply after 30 June 2016 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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).

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## Scheme

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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:

- the application for a Class Ruling dated 20 July 2012 (**Application**);
- the Draft of the Aquila Resources Limited Long Term Incentive Plan Rules and accompanying schedules submitted with the Application;
- the Draft pro forma Invitation Letter submitted with the Application;
- the Draft extract of the Share Trading Policy submitted with the Application; and
- additional correspondence related to the Class Ruling.

10. Aquila is an Australian company listed on the ASX primarily focused on the exploration and development of coal, iron ore and manganese resources in Australia and South Africa.

11. The Plan is part of Aquila's remuneration program which seeks to both retain and reward participants in support of Aquila's business strategy.

12. The Plan provides for eligible employees, who must be approved by the board of directors of Aquila or the remuneration committee, if the board of directors (Board) so determines (or any other persons to whom powers under the Plan are delegated by the Board), to receive an offer (Invitation) of Performance Rights and/or Share Appreciation Rights.

13. Rights are rights to acquire fully paid ordinary shares in Aquila and are subject to the Plan Rules and the terms set out in the Invitation. The terms, conditions and restrictions set out in the Invitation may provide that they prevail to the extent of any inconsistency between the terms, conditions and restrictions set out in the Invitation and the Plan Rules.

14. Rights may (at the election of the participant) be granted to a participant's permitted nominee.

15. Under the Plan rules, the Board will determine the procedure for offering and granting the Rights, including the form and content of any Invitation, offer and acceptance procedure, the number and type of Rights on offer (including, if the Board so determines, an ability for some participants to elect the relative mix and number of Share Appreciation Rights and Performance Rights) the performance period, the grant date and any vesting conditions which may apply.

16. The Rights will be granted to the participant on a date determined by the Board after Aquila receives a duly completed and signed acceptance form from a participant (the grant date).

17. Participants acquire the Rights for no consideration and at a discount to their market value.

18. A Right granted to a participant will be forfeited if the participant does not remain employed by Aquila for a period specified in the Invitation, which will be at least six months from the grant date (Employment Condition).

19. Subject to the Performance Criteria (if any) and the Employment Condition being satisfied, a Performance Right or Share Appreciation Right that has not previously lapsed vests on the Vesting Date.

20. The Rights will not vest until the date specified in a Vesting Notice issued by the Board advising the participant of the number of Rights that have vested, the vesting date of those Rights and the number of Shares that will be issued or transferred to the participant in respect of those Rights.

21. On vesting of a Performance Right, Aquila must issue or cause to be transferred to the participant one Aquila share for no further consideration.

22. On the Vesting Date, in respect of all Share Appreciation Rights which vest on that Vesting Date, the participant will be entitled to receive from Aquila, an aggregate amount equal to the difference between the market value (as determined under the Plan rules) of one share at the end of the Performance Period and its market value at the start of the Performance Period multiplied by the total number of that participant's Share Appreciation Rights that vest on that Vesting Date. The aggregate amount so determined will be settled in such number of Aquila shares (rounded down to the nearest whole number) as is equal to the aggregate amount divided by the market value of an Aquila share on the last day of the Performance period.

23. On vesting of Share Appreciation Rights Aquila must issue or cause to be transferred to the participant such Aquila shares for no further consideration.

24. The Performance Period is:
- i. in respect of a Right which is tested against periodic performance criteria, the period specified in the Invitation during which the performance criteria will be applied;
  - ii. in respect of a Right which is tested on the occurrence of a specific event, the period between the grant date and the date of that event;
  - iii. in respect of a Right which is subject to an Employment Condition, the period during which the Employment Condition will be applied;

and in respect of a Right which is subject to one or more the above, the longest of those periods.

25. Ordinarily the Rights will not vest until their Vesting Date subject to the Employment Condition and the Performance Criteria (if any) having been satisfied. However, under the Plan rules, (i) the Board may (in its discretion) when a participant leaves the employment of Aquila (or its subsidiary), determine that some or all of the Rights vest early (upon the cessation of the participants employment) and (ii) all unvested Rights automatically vest upon the occurrence of a Change of Control Event (as defined in the Plan rules) (as if all Performance Criteria (if any) and the Employment Condition (if any) in connection with the Performance Rights have been satisfied). In relation to (i), the Board will not routinely exercise this discretion, but will consider each case on its merits. In relation to (ii), at the date of this Ruling, Aquila is not aware of a Change of Control Event in relation to Aquila.

26. Where the minimum employment condition is for a period of at least six months but less than 12 months the terms and conditions of the Invitation and Plan rules will be such as to ensure that subsection 83A-120(2) of the ITAA 1997 would apply no later than three years from the time a right is granted to a participant.

27. The terms of the Plan rules and Invitation provide that once participants are issued or transferred shares upon vesting of the Rights, the participants are subject to transfer restrictions in accordance with the Aquila Resources Share Trading Policy. The Share Trading Policy states that participants are assumed at all times to have inside information in respect of Aquila and are therefore restricted from trading in the shares until the Chairman of the Board or the Board (as appropriate) has granted approval in writing to the participant to trade the shares acquired on vesting of the Rights. The Share Trading Policy may, in the future, additionally state that the Company Secretary will be entitled to grant the above-mentioned approval.

28. The predominant business of Aquila is not the acquisition, sale or holding of shares, securities or other investments.

29. Immediately after acquiring the Rights none of the participants holds a beneficial interest in more than 5% of Aquila nor are they in a position to cast or control the casting of, more than 5% of the maximum number of votes that might be cast at a general meeting of Aquila.

## Ruling

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### Acquisition by nominee

30. Where a Right is granted to a participant's nominee, the Right and any shares subsequently acquired on vesting of the Right are taken for the purposes of Division 83A to have been granted to and/or acquired by the participant. Where the nominee disposes of the share acquired upon vesting of the Right, the participant is taken for the purposes of Division 83A to have disposed of the share. All the terms and conditions which apply to the nominee in relation to the Rights and shares are taken to apply to the participant (section 83A-305).

### Granting of Rights

31. A participant who is granted a Performance Right under the Plan acquires an ESS interest in terms of subsection 83A-10(1).

32. A participant who is granted Share Appreciation Rights under the Plan will be taken to have acquired ESS interests at the grant date once the number of shares to be acquired in respect of those Share Appreciation Rights has been determined in accordance with section 83A-340 and subsection 83A-10(1).

### ESS deferred taxing point

33. No amount will be included in the participant's assessable income in relation to a Right until the ESS deferred taxing point for the Right occurs.

34. The ESS deferred taxing point for the Right will be the earliest of the following times:

- when the participant ceases to be employed by Aquila (or any of its subsidiaries) (subsection 83A-120(5));
- the end of the seven year period commencing when the participant acquired the Right (subsection 83A-120(6));
- the time that the participant is first notified in writing by either the Chairman of the Board, the Company Secretary or the Board (as appropriate) that the participant has been granted approval to trade the shares acquired upon the vesting of the Rights (subsection 83A-120(7)).

However, where the participant disposes of the share (arising from the Right) within 30 days of the first occurrence of one of the abovementioned times, the ESS deferred taxing point will instead be the time of disposal (subsection 83A-120(3)).

### **Capital gains tax**

35. The granting of a Right to a participant does not result in a CGT event for the participant.

36. Where the ESS deferred taxing point of a Right occurs before disposal of the share acquired pursuant to the Right:

- the time of acquisition of the share is taken to be immediately after the ESS deferred taxing point, in accordance with section 83A-125, and
- the first element of the cost base and reduced cost base of the share is its market value immediately after the ESS deferred taxing point, in accordance with section 83A-125, section 112-15 and either subsection 110-25(2) or 110-55(2).

37. Where the ESS deferred taxing point of a Right happens at the time of disposal of the share acquired pursuant to the Right, any capital gain or capital loss made by a participant from that disposal is disregarded in accordance with subsection 130-80(1).

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**Commissioner of Taxation**

23 January 2013

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## 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.***

### ***Acquisition by nominee***

38. If an associate of a participant acquires a right that is an ESS interest in relation to the participant’s employment, section 83A-305 operates to:

- treat the Right as having been acquired by the participant;
- treat any circumstance, right or obligation existing or not existing in relation to the Right in relation to the associate as existing or not existing in relation to the participant; and
- treat anything done or not done by or in relation to the associate as having been done or not done by or in relation to the participant.

39. *Associate* is defined in subsection 995-1(1) as having the meaning given by section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936).

40. Where a participant elects to have their Rights granted to a nominee and that nominee is an associate as defined in subsection 995-1(1) of the ITAA 1936, section 83A-305 would operate to treat the Right as having been acquired by the participant.

41. Where the nominee disposes of the share acquired upon vesting of the Right, the participant is taken for the purposes of Division 83A to have disposed of the share.

42. All the terms and conditions which apply to the nominee in relation to the Rights and shares are taken to apply to the participant. This would include such things as the trading restrictions placed upon the shares and Performance Criteria which apply to the Rights.

### ***Acquisition of Performance Rights***

43. A Performance Right is a right to acquire a beneficial interest in a share in Aquila in accordance with subsection 83A-10(1) and is acquired by a participant at the time it is granted by Aquila.

***Acquisition of Share Appreciation Rights***

44. Share Appreciation Rights do not, at the time of grant, entitle a participant to acquire a specified number of Aquila shares. Instead, the proportionate number of shares which each Share Appreciation Right represents is determined by reference to the increase in the price of an Aquila share over the performance period and therefore cannot be determined until the end of the specified performance period.

45. A Share Appreciation Right is not considered to be a right to acquire a beneficial interest in a share until the time when the proportionate number of shares that each Share Appreciation Right represents is determined.

46. Once the proportionate number of shares that each Share Appreciation Right represents is determined, section 83A-340 operates to treat such rights as though they had always been rights to acquire beneficial interests in shares.

***Real risk of forfeiture***

47. 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.

48. 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 'ESS deferred taxing point') 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).

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

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

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

52. 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.

53. 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.

54. 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.

55. 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 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).

56. 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.

57. '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.

58. Rights granted under the Plan vest subject to a participant meeting a minimum employment condition and vesting may also be subject to performance conditions.

59. The minimum employment condition will be for a period of at least six months from the date of grant of the Rights to the participant. Where the minimum employment condition is for a period of at least six months but less than 12 months the terms and conditions of the Invitation and Plan rules will be such as to ensure that a deferred taxing point for a participant's Rights can occur no later than three years from the date of grant of the Rights.

60. Therefore subject to the discussion below regarding the discretion of the Board, the Commissioner accepts that the Rights granted are at the time of acquisition subject to a real risk of forfeiture or loss for the purposes of paragraphs 83A-105(1)(d) and 83A-105(3)(b).

**Board discretion**

61. The Plan rules provide that the Board has a discretion to allow participants to retain some or all of their Rights should they cease employment prior to the normal Vesting date.

62. The applicant has advised that the discretion will not be exercised on a routine basis to allow participants voluntarily ceasing employment to retain their unvested Rights.

63. No participant will know at the time they acquire their Rights whether they will receive their unvested Rights if they cease employment during the vesting period as no participant can predict with confidence whether the Board will exercise its discretion favourably at the time of their ceasing employment.

64. As the Board's discretion is not routinely exercised to allow a participant to retain their Rights, the Commissioner does not consider that the availability of a discretion as described will prevent the Rights from being at real risk of forfeiture.

65. 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.

66. 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**

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

68. 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)).

69. Subsection 83A-120(4) cannot apply as the Plan rules do not provide for the disposal of the Rights.

70. The terms of the Plan rules and Invitation provide that once participants are issued or transferred shares upon vesting of the Rights, the participants are subject to transfer restrictions in accordance with the Aquila Resources Share Trading Policy. The Share Trading Policy will state that participants are assumed at all times to have inside information in respect of Aquila and are therefore restricted from trading in the shares until the Chairman of the Board or the Board (as appropriate) has granted approval in writing to the participant to trade the shares acquired on vesting of the Rights. The Share Trading Policy may, in the future, additionally state that the Company Secretary will be entitled to grant the above-mentioned approval.

71. Where a participant forfeits a Right prior to the vesting time section 83A-310 operates such that Division 83A (apart from Subdivision 83A-E) is taken never to have applied to the Right provided that the forfeiture or loss is not the result of:

- a choice made by the participant (other than a choice by that participant to cease particular employment); or
- a condition of the scheme that has the direct effect of protecting (wholly or partly) the participant against a fall in the market value of the interest.

72. Rights will only be forfeited as a result of not meeting the Performance Criteria (if any) or the Employment Condition.

73. Because the Rights vest at the same time as they automatically exercise for no further consideration and because the shares are not subject to forfeiture the Commissioner is satisfied that there is no condition of the scheme which has the direct effect of protecting the participant against a fall in the market value of the Right or share.

74. Therefore where a participant forfeits a Right prior to the vesting time section 83A-310 operates such that Division 83A (apart from Subdivision 83A-E) is taken never to have applied to the Right.

75. The ESS deferred taxing point will therefore be the earliest of the following times:

- when the participant ceases employment with Aquila (subsection 83A-120(5));
- the end of the seven year period commencing when the participant acquired the Right (subsection 83A-120(6)).

- the time that the participant is first notified in writing by either the Chairman of the Board, the Company Secretary or the Board (as appropriate) that the participant has been granted approval to trade the shares acquired upon the vesting of the Rights (subsection 83A-120(7)).

76. However, where the participant disposes of the share within 30 days of the first occurrence of one of the abovementioned times, the ESS deferred taxing point will instead be the time of disposal (subsection 83A-120(3)).

### **Capital Gains Tax**

#### ***CGT consequences of forfeiture***

77. Where the Rights are forfeited on or before the ESS deferred taxing point, CGT event C2 happens in accordance with subsection 104-25(1).

78. Where CGT event C2 happens, a capital gain is made if the capital proceeds from the event are more than the asset's cost base. A capital loss is made if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)). In accordance with subsection 130-80(2), where CGT event C2 happens because a Right is forfeited on or before the ESS deferred taxing point, subsection 130-80(1) does not apply to disregard any capital gain or capital loss.

79. Although a participant pays no consideration for a Right, the market value substitution rule for cost base and reduced cost base in section 112-20 does not apply, in accordance with subsection 130-80(4).

80. Although a participant receives no capital proceeds from the forfeiture of a Right, the market value substitution rule for capital proceeds in section 116-30 also does not apply, in accordance with subsection 130-80(4).

81. Therefore, as a result of subsection 130-80(4), a participant will not make a capital gain or a capital loss (if there are no amounts included in elements of the reduced cost base under section 110-55 other than the first element) from forfeiting a Right.

#### ***Time of acquisition of shares***

82. The time of acquisition of a Share acquired pursuant to a Right to which this Ruling applies is immediately after the ESS deferred taxing point of the Right, unless the ESS deferred taxing point occurs at the time the interest is disposed of, in accordance with section 83A-125.

### ***First element of the cost base of shares***

83. The first element of the cost base and reduced cost base of a share acquired by a participant pursuant to a Right to which this Ruling applies is the market value of the share immediately after the ESS deferred taxing point of the Right, in accordance with section 83A-125, section 112-15, subsection 110-25(2) and subsection 110-55(2).

### ***Disposal at ESS deferred taxing point***

84. Where the ESS deferred taxing point of a Right happens at the time of disposal of the share acquired pursuant to the Right, any capital gain or capital loss made by a participant from that disposal is disregarded in accordance with subsection 130-80(1).

### ***Disposal after ESS deferred taxing point***

85. CGT event A1 happens if there is a change in ownership of a CGT asset from one entity to another. Where a participant disposes of a Share, the disposal will constitute a CGT event A1 (section 104-10).

86. A capital gain is made if the capital proceeds from the disposal are more than the Share's cost base. A capital loss is made if those capital proceeds are less than the Share's reduced cost base (subsection 104-10(4)).

87. Subsection 116-20(1) provides that the capital proceeds from a CGT event is the total of:

- the money received or entitled to be received; and
- the market value of any property received or entitled to be received (worked out as at the time of the event).

88. Consequently, the capital gain, with respect to a share, will be equal to the money and the market value of any property the participant receives in respect of the disposal less the sum of the market value of the share at the ESS deferred taxing point and the other elements of the cost base identified in accordance with section 110-25.

### ***Discount capital gain***

89. A participant who makes a capital gain from the disposal of shares may be entitled to treat the gain as a discount capital gain in respect of those shares that have been held for at least 12 months, provided the other requirements of Subdivision 115-A are satisfied (section 115-25).

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

90. 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:*

TR 2006/10;

*Subject references:*

- employee share schemes and options

*Legislative references:*

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ATO references

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