

CR 2014/16 - Income tax: Downer EDI Limited Long Term Incentive Plan

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Class Ruling

Income tax: Downer EDI Limited Long Term Incentive Plan

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	7
Scheme	8
Ruling	30
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	41
Appendix 2:	
<i>Detailed contents list</i>	79

📌 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.

[Note: *This is a consolidated version of this document. Refer to the Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

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)
 - Subdivision 83A-C of the ITAA 1997
 - section 83A-10 of the ITAA 1997
 - section 83A-110 of the ITAA 1997
 - section 83A-120 of the ITAA 1997, and
 - section 83A-340 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 directors and employees of Downer EDI Limited (Downer) or its subsidiaries (Downer Group) who:

- receive Performance Rights (Rights) under the Downer EDI Limited Long Term Incentive Plan (the Plan);
- are residents of Australia within the meaning of that expression in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- are not temporary residents within the meaning of that expression in subsection 995-1(1).

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 8 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.

Date of effect

7. This Ruling applies from 1 July 2013. 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

8. 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 1 October 2013 (Application);

- the Downer EDI Limited Long Term Incentive Plan Rules (the Plan Rules) and accompanying schedules;
- the pro forma Invitation Letter submitted with the Application;
- the Downer EDI Limited Long Term Incentive Plan 2013 Offer Booklet,
- the Downer EDI Limited Securities Trading Policy, and
- additional correspondence related to the Class Ruling.

Note : *certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.*

9. Downer is a public company listed on the ASX, primarily focused on engineering and infrastructure management services.

The Plan

10. The Plan is a long term incentive scheme for a limited number of senior executives of the Downer Group.

11. The Plan provides for senior executives selected by the Downer Board to receive an offer (Invitation) of Rights.

12. The Rights are rights to acquire fully paid ordinary shares in the capital of Downer (Shares) or to be paid an amount of cash consideration in certain circumstances, and are subject to the Plan Rules and the terms set out in the Invitation.

13. The Rights will only be granted to Participants upon receipt by Downer of a completed and signed application form from the Participant. The Rights will be granted to the Participant on the date that Downer's Remuneration Committee approves the Participant's application.

14. Participants acquire their Rights for no consideration and at a discount to their market value which is greater than nil.

15. Where the specified vesting conditions are met, the Board will give the Participant a notice specifying the number of Rights which will vest, the date the Rights will vest (Vesting Date) and in certain circumstances, whether the Rights will be settled by the issue/transfer of Shares or the payment of cash consideration.

16. Prior to the Vesting Date, Participants will not have any interest in Shares which may be issued or transferred or any entitlement to cash consideration which may be paid to the Participants on the Vesting Date.

17. Immediately after acquisition of the Rights, none of the Participants will hold a beneficial interest in more than 5% of Downer and are not 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 Downer.

18. The predominant business of Downer 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

19. The Rights will be issued in two tranches and will vest subject to the satisfaction of three vesting conditions. The first, the 'performance vesting condition', is performance based and is unique to each tranche. The second and third are the 'continued employment condition', and the 'Board approval condition', and are common to both tranches.

20. Any Rights that fail the vesting conditions will lapse and be forfeited, subject only to a Participant being designated an 'Eligible Leaver'.

Performance vesting condition

21. A performance vesting condition applies to each tranche of Rights. The performance vesting conditions that need to be satisfied are:

- tranche 1 – Relative Total Shareholder Return (TSR); and
- tranche 2 – Compound Annual Earnings Per Share (EPS).

These are measured over a performance period starting on 1 January 2013 and ending on 31 December 2015.

Continued employment condition

22. If a Participant ceases employment with the Downer Group prior to 31 December 2016, their Rights are forfeited. However, if a Participant ceases employment with the Downer Group and the Board designates them an 'Eligible Leaver', this condition is waived. In those circumstances, the Eligible Leaver's unvested Rights will still be subject to the other vesting conditions.

23. The Board's discretion to designate a Participant as an Eligible Leaver is not intended to be routinely exercised, and no Participant will know at the time they acquire their Rights whether or not they will become an Eligible Leaver.

Board approval condition

24. As soon as practicable after the date the continued employment condition is satisfied, the Board will determine the extent of vesting of any Rights which have satisfied the other vesting conditions. The Board may reduce partly or fully the number of Rights that vest in certain circumstances.

Vesting of Rights under the Plan

25. Where Rights under the Plan vest, the Board will settle each vested Right by the issue or transfer of one Share for nil consideration, except in respect of Eligible Leavers.

26. Where a Participant is designated an Eligible Leaver the Board may elect to settle each vested Right by the issue or transfer of one Share for nil consideration or by paying an amount of cash consideration equal to the market value of a Share on the Vesting Date.

Disposal Restrictions

27. The terms of the Plan provide that once Participants are issued or transferred Shares upon vesting of Rights, they may not transfer those Shares until the Remuneration Committee, Company Secretary or Chairman approves a Transfer Notice submitted by a Participant and notifies the Participant of a fixed period in which to transfer the Shares. The Shares are placed in a holding lock within the meaning of the ASX listing rules until such approval has been obtained.

28. This transfer restriction ceases to apply to Eligible Leavers and to Participants who cease to be employed by the Downer Group after their Rights have vested.

29. All senior executives (from whom the Participants are selected) are assumed to have insider information in respect of Downer. Accordingly, an additional transfer restriction under Downer's Securities Trading Policy prohibits them from dealing in Downer securities during certain periods, or otherwise without prior approval of the Company Secretary/Chairman of the Board.

Ruling

Where Rights are settled with shares

30. Rights acquired under the Plan are indeterminate rights for the purposes of section 83A-340. Once the vesting conditions have been met, and the Rights have been settled with Shares, the Rights will be treated as rights to acquire beneficial interests in Shares from the time the Rights were acquired by the Participants.

31. These Rights are ESS interests for the purpose of subsection 83A-10(1).

Subdivision 83A-C

32. Rights acquired by Participants under the Plan are at real risk of forfeiture and Subdivision 83A-C applies to the Rights where they are treated as ESS interests under section 83A-340.

33. No amount will be included in the Participant's assessable income in relation to Rights until the ESS deferred taxing point for the Rights occur.

34. The ESS deferred taxing point for the Rights will be determined under section 83A-120.

35. For an Eligible Leaver who ceased employment within the meaning of the term in section 83A-330 and whose Rights are settled with Shares, the ESS deferred taxing point will be:

- the date they ceased employment (subsection 83A-120(5)).

36. For an Eligible Leaver who ceased employment otherwise than within the meaning of the term in section 83A-330 and whose Rights are settled with Shares, the ESS deferred taxing point will be:

- the Vesting Date (subsection 83A-120(7)).

37. The ESS deferred taxing point for the Rights of a 'non Eligible Leaver' (a Participant who does not cease employment prior to the Vesting Date), which are settled with Shares, will occur at the earliest of the following times:

- if a Participant ceases employment after the Vesting Date, the date they cease employment (subsection 83A-120(5));
- seven years after they acquired the Rights (subsection 83A-120(6)); or
- the first day of the fixed trading period approved by the Remuneration Committee, the Company Secretary or Chairman and notified to the Participant as described in paragraph 27 (subsection 83A-120(7)).

38. For any Participant who disposes of the Shares 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)).

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

Where Rights are satisfied in cash

40. Where an Eligible Leaver's Rights are satisfied in cash, the cash payment will be included in the assessable income of the Eligible Leaver in the year in which it is received under section 6-5.

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. The Rights will vest subject to meeting performance vesting and continued employment conditions and to the extent determined under the Board approval condition.

43. However, where a Participant leaves Downer's employment before meeting the employment condition, the Board has the discretion to determine that the Participant is an Eligible Leaver. Upon meeting all other vesting conditions, the Board has the discretion to satisfy an Eligible Leaver's Rights with a cash payment in lieu of Shares. Until such time as the Board has determined to settle a Right with a Share, a 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 rights which later become rights to acquire a beneficial interest in a share:

Example 1: You acquire a right to acquire, at a future time:

- a. shares with a specified total value, rather than a specified number of shares; or
- b. an indeterminate number of shares.

Example 2: You acquire a right under which the provider must provide you with either ESS interests or cash, whichever the provider chooses.

47. At the time the Participants acquire their Rights, it is uncertain, in the event the Rights vest, whether they will be settled with Shares or satisfied in cash. Therefore, the Participants do not yet have a right to acquire a beneficial interest in a share for the purpose of the definition of ESS interest in subsection 83A-10(1).

48. Accordingly, where Rights granted to a Participant become rights to acquire Shares, section 83A-340 will apply to those Rights as if they had always been a right to acquire a beneficial interest in a share.

49. These Rights will be ESS interests acquired under an employee share scheme under subsection 83A-10(2) as the Rights are granted to a Participant in relation to their employment as an employee of a company in the Downer Group.

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

Subdivision 83A-C

Real Risk of Forfeiture

51. 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.

52. 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).

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

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

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

56. 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.

57. 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.

58. 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.

59. 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).

60. 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.

61. '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.

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

63. Unvested Rights in each tranche will be forfeited if the relevant performance vesting condition for that tranche has not been satisfied, based on an assessment of Downer's financial results for the period ending 31 December 2015.

64. A performance vesting condition applies to each tranche of Rights. The performance vesting conditions that need to be satisfied are:

- tranche 1 – Relative Total Shareholder Return (TSR); and
- tranche 2 – Compound Annual Earnings Per Share (EPS).

These are measured over a performance period starting on 1 January 2013 and ending on 31 December 2015.

65. The Commissioner accepts that the 'real risk of forfeiture' test is met for Rights granted under the Plan.

66. 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.

67. 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

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

69. Section 83A-120 provides that the ESS deferred taxing point for the Rights will occur at the earliest of the following times:

- when the Rights have not been exercised, there is no real risk of forfeiting the Rights, and the scheme no longer genuinely restricts disposal of the Rights (subsection 83A-120(4));
- when the Participant ceases 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 Rights or underlying Shares, and the scheme no longer genuinely restricts exercise of the Rights or disposal of the resulting Shares (subsection 83A-120(7)).

70. 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)).

ESS deferred taxing point for Eligible Leavers

71. Where an Eligible Leaver's Rights are settled with Shares, and they ceased employment within the meaning of the term in section 83A-330, their ESS deferred taxing point will be:

- the date they ceased employment (subsection 83A-120(5))

72. Where an Eligible Leaver's Rights are settled with Shares, and they ceased employment otherwise than within the meaning of the term in section 83A-330, their ESS deferred taxing point will be:

- the Vesting Date (subsection 83A-120(7)).

However, if an Eligible Leaver disposes of the Shares 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)).

ESS deferred taxing point for 'non Eligible Leavers'

73. The ESS deferred taxing point for the Rights of a 'non Eligible Leaver' which are settled with Shares will occur at the earliest of the following times:

- if a Participant ceases employment after the Vesting Date, the date they cease employment (subsection 83A-120(5));
- seven years after they acquired the Rights (subsection 83A-120(6)), or
- the first day of the fixed trading period approved by the Remuneration Committee, Company Secretary or Chairman and notified to the Participant as described in paragraph 27 (subsection 83A-120(7)).

However, if a 'non Eligible Leaver' disposes of the Shares 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

74. In accordance with section 83A-110, where rights are settled with Shares, 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.

Where Rights are satisfied in cash

75. Where an Eligible Leaver's Rights are satisfied in cash, section 83A-340 will not apply to the Rights. The Rights will not be considered ESS interests under subsection 83A-10(1) and Division 83A will not apply to the Rights.

76. In these circumstances, 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*.

77. 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.

78. Therefore, the Eligible Leaver 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).

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	7
Scheme	8
The Plan	10
<i>Vesting conditions</i>	19
<i>Performance vesting condition</i>	21
<i>Continued employment condition</i>	22
<i>Board approval condition</i>	24
Vesting of Rights under the Plan	25
<i>Disposal Restrictions</i>	27
Ruling	30
Where Rights are settled with shares	30
Subdivision 83A-C	32
Where Rights are satisfied in cash	40
Appendix 1 – Explanation	41
Where Rights are settled with shares	
<i>ESS Interests</i>	41
<i>Indeterminate rights</i>	44
Subdivision 83A-C	
<i>Real Risk of Forfeiture</i>	51
<i>ESS deferred taxing point</i>	68
<i>ESS deferred taxing point for Eligible Leavers</i>	71
<i>ESS deferred taxing point for ‘non Eligible Leavers’</i>	73
<i>Amount included in assessable income</i>	74
Where Rights are satisfied in cash	75
Appendix 2 – Detailed contents list	79

References

- Previous draft:*
- ITAA 1997 83A-10(2)
- Not previously issued as a draft
- ITAA 1997 83A-25(1)
 - ITAA 1997 83A-105
 - ITAA 1997 83A-105(1)
- Related Rulings/Determinations:*
- ITAA 1997 83A-105(3)
 - ITAA 1997 83A-110
 - ITAA 1997 83A-120
 - ITAA 1997 83A-120(3)
- TR 2006/10
- Subject references:*
- ITAA 1997 83A-120(4)
 - ITAA 1997 83A-120(5)
 - ITAA 1997 83A-120(6)
 - ITAA 1997 83A-120(7)
- employee share schemes
- Legislative references:*
- ITAA 1936 6(1)
 - ITAA 1997 Div 83A
 - ITAA 1997 Subdiv 83A-B
 - ITAA 1997 Subdiv 83A-C
 - ITAA 1997 6-5
 - ITAA 1997 6-5(2)
 - ITAA 1997 83A-10
 - ITAA 1997 83A-10(1)
 - ITAA 1997 83A-330
 - ITAA 1997 83A-340
 - ITAA 1997 995-1(1)
 - FBTAA 1986 136(1)(f)
 - TAA 1953
 - Copyright Act 1968

ATO references

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