CR 2004/62 - Income tax: Employee Share Scheme: Fantastic Holdings Limited Employee Share Participation Plan

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Class Ruling

Income tax: Employee Share Scheme: Fantastic Holdings Limited Employee Share Participation Plan

Contents Para

Preamble

The number, subject heading, ***What this Class Ruling is about*** *(including* ***Tax law(s)****,* ***Class of persons*** *and* ***Qualifications*** *sections),* ***Date of effect****,* ***Arrangement*** *and* ***Ruling*** *parts of this document are a 'public ruling' in terms of Part IVAAA of the* ***Taxation Administration Act 1953****. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are sections:

- 139B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- 139BA of the ITAA 1936;
- 139C of the ITAA 1936;
- 139CA of the ITAA 1936;
- 139CC of the ITAA 1936;
- 139CD of the ITAA 1936;
- 139CE of the ITAA 1936;
- 139E of the ITAA 1936;
- 139FA of the ITAA 1936;
- 139FB of the ITAA 1936;
- 139G of the ITAA 1936;
- 139GF of the ITAA 1936;

- 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- 6-10 of the ITAA 1997
- 130-80 of the ITAA 1997; and
- 130-83 of the ITAA 1997.

Class of persons

3. The class of persons to whom this Ruling applies are the Australian resident employees of the Fantastic Holdings Group (the Fantastic group) who participate in the Fantastic Holdings Limited Employee Share Participation Plan (ESPP) as described in the Arrangement part of this Ruling.

4. The Fantastic group comprises Fantastic Holdings Limited (Fantastic), Fantastic Furniture Pty Ltd, Fantastic Metal Furniture Pty Ltd, Fantastic Furniture Licensing Pty Ltd and Best Buy Pty Ltd.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 10 to 20 is carried out in accordance with the details of the arrangement provided in this Ruling.

7. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 March 2004. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the Gazette;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- Class Ruling application dated 16 April 2003;
- letter from Felsers (Fantastic's representatives) dated 17 March 2004 with attached amended rules of the Fantastic Holdings Limited ESPP; and
- employee booklet covering the Plan.

These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

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

11. The ESPP was established to assist in retaining and motivating employees of the Fantastic group. The board of directors of Fantastic (the board) are responsible for the administration of the ESPP in accordance with the ESPP rules as amended in March 2004.

12. The ESPP is a broadly based scheme available to all full-time and permanent part-time employees (eligible employees) that meet a minimum 6 months service requirement. Ninety percent of all employees are full time or permanent part-time employees, therefore at least seventy five percent of permanent employees are entitled to participate in the ESPP.

13. Offers to participate in the ESPP will be made to all eligible employees and the offer document specifies the price at which the board will invite eligible employees to acquire shares. Employees who accept the offer become participating employees.

14. Shares acquired under the ESPP will be partly funded up to 90% of the cost, by an effective salary sacrifice arrangement (SSA) of a minimum of $3000 per annum. An effective SSA is within the meaning of paragraphs 19 to 23 of Taxation Ruling TR 2001/10. Participating employees will not be required to contribute any other funds in order to acquire ordinary shares in Fantastic.

15. Amounts that are salary sacrificed are accumulated over three monthly contribution periods and are credited to a special purpose bank account. Fantastic will also maintain a notional plan account in respect of each participating employee.

16. Within 75 days of the end of a contribution period Fantastic must either subscribe for or acquire fully paid shares on behalf of the participating employee. All shares acquired or subscribed for will be registered in the name of the employee. The number of shares to be acquired or subscribed for is limited to the number of shares that can be obtained by using the amount of credit in the employee's notional plan account.

17. The ESPP rules stipulate that a participating employee must not sell or transfer the plan shares within 10 years of the issue date unless they cease to be an employee of the Fantastic group at an earlier time.

18. Under the ESPP there are no rules or other conditions that can result in forfeiture of shares acquired under the scheme.

19. Under the ESPP rules if a participating employee ceases to be an employee of the Fantastic group, a credit balance in their notional plan account may be paid in cash to the employee.

20. The ESPP rules also stipulate that no participating employee is allowed to obtain shares under the plan if it will result in them holding a legal or beneficial interest in more than 5% of the shares in Fantastic or puts them in a position to vote or control the voting of more than 5% of the shares in Fantastic.

Ruling

All references are to the Income Tax Assessment Act 1936 unless otherwise specified

21. Where a participating employee acquires shares under the ESPP they are qualifying shares for the purposes of section 139CD.

Where an employee makes an election

22. Where a participating employee makes an election under section 139E, the discount on the shares will be included in their assessable income in the year of income in which the shares are acquired, pursuant to subsection 139B(2).

23. The discount to be included in the employee's assessable income is equivalent to the market value of the shares at the time they are acquired. The market value of a share at this time is determined under section 139FA. As the exemption conditions in section 139CE have been satisfied only the amount of the discount greater than $1,000 is included in assessable income.

24. Under subsection 130-80(2) of the ITAA 1997, the first element of the cost base or reduced cost base of each share that is acquired under the ESPP is the market value of the share at the time it is acquired.

Where an employee does not make an election

25. Where a participating employee does not make an election under section 139E, the discount on the shares will be included in their assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

26. The cessation time will be the earliest of:

- the time when the employee disposes of the shares;
- the time when any restriction preventing the employee from disposing of the shares ceases to have effect;
- the time when the employee ceases employment with their employer or a company in the Fantastic group; and
- the end of the 10 year period starting when the employee acquired the shares.

Disposal within 30 Days

27. Where the employee disposes of the shares in an arm's length transaction within 30 days of the cessation time, the discount assessable at the cessation time will be the amount of consideration received on the disposal of the shares in accordance with subsection 139CC(3).

28. Any capital gain or capital loss made as a consequence of such a disposal is disregarded.

Disposal after 30 Days

29. Where the shares are not disposed of by the employee in an arm's length transaction or within 30 days of the cessation time, the discount will be the market value of the share at the cessation time in accordance with subsection 139CC(4).

30. The first element of the cost base or reduced cost base of the shares upon a CGT event occurring will be their market value at the cessation time.

Explanation

31. For Division 13A of Part 111 (Division 13A) to apply to shares acquired under the ESPP, those shares must be acquired under an employee share scheme as defined in section 139C.

32. Section 139G provides that a person acquires a share in several circumstances, including by having a share allotted to them by another person. A participating employee acquires a share when it is issued to them by the board in accordance with the ESPP rules.

33. Subsection 139C(1) provides that a share is acquired under an employee share scheme if the share is acquired in respect of, or in relation directly or indirectly to, any employment of the taxpayer. This condition is satisfied with respect to shares acquired by participating employees under the ESPP.

34. Subsection 139C(3) provides that a share is not acquired under an employee share scheme unless it is acquired for less than its market value. This condition is satisfied under the ESPP as participating employees are not required to make any payment to acquire the shares. Amounts foregone by an employee under a SSA in relation to the ESPP, do not form part of consideration paid or given by an employee for the acquisition of shares.

35. Therefore, participating employees acquire shares under an employee share scheme within the meaning in section 139C, as the shares are acquired by them for less than market value and in respect of or in relation to their employment.

36. Where an employee acquires shares under an employee share scheme, the discount given is included in assessable income in accordance with section 139B.

37. The time at which the discount is included in a participating employee's assessable income depends on two material factors. The first is whether the shares are 'qualifying shares' within the meaning of that term in section 139CD. The second is whether the employee has made an election under section 139E to include the discount in assessable income in the year the shares are acquired.

38. A share is a qualifying share for the purposes of Division 13A if it meets the six conditions specified in section 139CD. Shares acquired under the ESPP are qualifying shares because:

- they are acquired under an employee share scheme;
- the share is a share in a company which is the employer or the holding company of the employer of the participating employee;
- the shares are ordinary shares;
- at least 75% of the permanent employees of the employer have been eligible to acquire shares under the ESPP;

- the restriction on ownership not exceeding 5% is complied with; and
- the restriction on voting power not exceeding 5% is complied with.

Where an employee makes an election

39. An employee can elect under section 139E that subsection 139B(2) applies for a year of income. The election will apply to each qualifying share acquired by the employee in the year of income. Subsection 139B(2) provides that the discount on a share is included in the taxpayer's assessable income in the year of acquisition of the share, that is, in the year when Fantastic issued the share to the employee.

40. The amount of the discount to be included in assessable income is calculated in accordance with subsection 139CC(2). As the employee does not provide any consideration for the acquisition of the share, the discount is equivalent to the market value of the share, at the time it was acquired by the employee.

41. Subdivision F contains special provisions to determine the market value of shares on a particular day. As the ordinary shares in Fantastic are listed on the Australian Stock Exchange (ASX), section 139FA provides that their market value is:

- if there was at least one transaction on the ASX in those shares in the week up to and including the date of acquisition – the weighted average of the prices at which those shares were traded on the ASX during that week; or
- if there were no such transactions in the week up to and including the date of acquisition – the last price at which an offer was made on the ASX in that period to buy such a share, or if no offer was made, the value as determined under section 139FB.

$1,000 reduction in discount

42. Section 139CE contains exemption conditions that must be satisfied by the ESPP, for the participating employees to have access to the $1,000 tax free threshold provided for in subsection 139BA(2). The exemption conditions are:

- the scheme does not contain any conditions which could result in an employee forfeiting ownership of any shares that were acquired under the scheme;
- the scheme is operated so that no employee is permitted to dispose of shares acquired under the scheme until the earlier of:

  (a) three years after their acquisition; or

(b) the time when the employee is no longer employed within the Fantastic group or by the same employer as at the time the shares were acquired; and

- the scheme is operated on a non-discriminatory basis as set out in section 139GF.

43. The ESPP as outlined satisfies the forfeiture and disposal restrictions referred to in paragraph 42. Additionally the ESPP is operated on a non-discriminatory basis as the conditions in section 139GF are satisfied because all offers to acquire shares;

- are made to at least 75% of permanent employees;
- provide a reasonable time to accept an offer; and
- are made on the basis that the essential features of each offer will be the same for at least 75% of permanent employees.

44. As all the exemption conditions in section 139CE have been satisfied, subsection 139BA(2) will apply so that only the discount greater than $1,000 will be included in a participating employee's assessable income.

45. The first element of the cost base of the shares for the purposes of the CGT provisions will be determined in accordance with subsection 130-80(2) of the ITAA 1997. In this case it is the market value of the share determined by the operation of section 139FA.

Where an employee does not make an election

46. As the shares are qualifying shares, where a participating employee has not made an election under section 139E, the discount in relation to the shares will be included in assessable income in the year in which cessation time occurs, pursuant to subsection 139B(3). As the shares acquired under the plan are prohibited from disposal for 10 years after acquisition, subsection 139CA(2) will determine when cessation time occurs.

47. Under the ESPP, cessation time will be the earliest time when:

- the shares are disposed of;
- any restriction preventing the taxpayer from disposing of the share, ceases; or
- employment with the Fantastic group or by the same employer as at the time the shares were acquired, ceases.

Disposal within 30 days of cessation time

48. Subsection 139CC(3) calculates the discount to be included in assessable income where the shares are disposed of by the participating employee in an arm's length transaction within 30 days of the cessation time. As no consideration is paid or given by the participating employee for the shares, the proceeds received by the participating employee on disposal of the shares will be included in assessable income.

49. As the shares are qualifying shares and no election is made under section 139E in the year of income that the share was acquired, any capital gain or loss made on the disposal, outlined above, will be disregarded in accordance with subsection 130-83(2) of the ITAA 1997.

No disposal within 30 days of cessation time

50. Subsection 139CC(4) determines the amount of the discount to be included in the employee's assessable income where the shares are not disposed of by the employee in an arm's length transaction within 30 days of the cessation time. As no consideration is paid or given by the participating employee for the shares, the discount to be included is the market value of the shares at cessation time.

51. As the shares in Fantastic are listed on the ASX the market value of the shares for the purposes of paragraph 139CC(4)(a) will be determined in accordance with section 139FA (see paragraph 41).

52. The cost base of the shares for the purposes of the CGT provisions will be determined in accordance with subsection 130-83(3) of the ITAA 1997, the first element being the market value of the shares worked out under section 139FA at cessation time.

Payment to employees of excess contributions

53. Where a participating employee who ceases to be an employee of the Fantastic group, is paid some or all of a credit balance in their notional plan account, the payment is considered to be assessable salary and wages income to that employee under section 6-5 or 6-10 of the ITAA 1997 (see paragraphs 30 and 99 of Taxation Ruling TR 2001/10).

Detailed contents list

54. Below is a detailed contents list for this Class Ruling:

Commissioner of Taxation
16 June 2004

Previous draft:
Not previously released in draft form

Related Rulings/Determinations:
TR 92/1; TR 92/20; TR 97/6; TR2001/10; CR 2001/1

Subject references:
- Employee Share Schemes

Legislative references:
- ITAA 1936 139B
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139BA
- ITAA 1936 139BA(2)
- ITAA 1936 139C
- ITAA 1936 139C(1)
- ITAA 1936 139C(3)
- ITAA 1936 139CA
- ITAA 1936 139CA(2)
- ITAA 1936 139CC

- ITAA 1936 139CC(2)
- ITAA 1936 139CC(3)
- ITAA 1936 139CC(4)
- ITAA 1936 139CC(4)(a)
- ITAA 1936 139CD
- ITAA 1936 139CE
- ITAA 1936 139E
- ITAA 1936 139FA
- ITAA 1936 139FB
- ITAA 1936 139G
- ITAA 1936 139GF
- ITAA 1997 6-5
- ITAA 1997 6-10
- ITAA 1997 130-80
- ITAA 1997 130-80(2)
- ITAA 1997 130-83
- ITAA 1997 130-83(2)
- ITAA 1997 130-83(3)
- TAA 1953 Pt IVAAA
- Copyright Act 1968

ATO references
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