

CR 2005/104 - Income tax: Hewlett-Packard Company Amended 2000 Employee Stock Purchase Plan



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Class Ruling

Income tax: Hewlett-Packard Company Amended 2000 Employee Stock Purchase Plan

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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:

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

- section 139GB of the ITAA 1936;
- section 139GF of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 109-5 of the ITAA 1997;
- section 115-5 of the ITAA 1997;
- section 115-10 of the ITAA 1997;
- section 115-15 of the ITAA 1997;
- section 115-20 of the ITAA 1997;
- section 115-25 of the ITAA 1997;
- section 130-80 of the ITAA 1997; and
- section 130-83 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is all Australian resident employees of Hewlett-Packard Australia Pty Ltd and HP Financial Services (Australia) Pty Limited who are allocated shares in the Hewlett-Packard Company 2000 Employee Stock Purchase Plan (the Plan) as described in the arrangement part of this Ruling, on or after 1 November 2005. In this Ruling, a person belonging to this class of persons is referred to as a participating employee.

Qualifications

4. The Commissioner makes this Ruling based upon the precise arrangement as identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 9 to 24.

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

- 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

8. This Ruling applies to the income year commencing 1 July 2005 and to all subsequent years in which the arrangement is offered. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not 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

9. The arrangement that is the subject of this Ruling is described below. The description is based on the following documents. These documents, or relevant parts of them, as the case maybe, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Class Ruling Application dated 2 September 2005;
- Class Ruling Application dated 29 April 2005 (issued as Class Ruling CR 2005/85);
- Letter from applicant dated 26 September 2005;
- Letter from applicant dated 30 September 2005;
- Terms of the Hewlett-Packard Company 2000 Employee Stock Purchase Plan (the Plan Rules);

- The Employee Stock Purchase Plan – Australian Offer Document as amended and restated July 21 2005 (the Offer);
- The Hewlett-Packard Company Share Ownership Plan Enrolment and Payroll Deduction Authorisation Agreement (Enrolment Agreement);
- Prospectus for the Share Ownership Plan.

10. The Plan has been established as part of the employee incentive strategy of Hewlett-Packard Company (the Company) to enable eligible employees to purchase shares of common stock in the Company (shares).

11. The Plan commenced on 1 November 2000 and is administered by a Plan Administrator in accordance with the Plan Rules.

12. The applicant advised that all regular and part-time (working more than 20 hours a week) employees of Hewlett-Packard Australia Pty Ltd and HP Financial Services (Australia) Pty Limited are eligible to participate in the Plan.

13. Where an eligible employee, in accordance with the Plan Rules, completes and submits an Enrolment Agreement they become a participating employee.

14. The participating employee makes after-tax payroll contributions in accordance with their Enrolment Agreement, with the payroll contributions being paid into a trust account.

15. The Plan Administrator uses the participating employee's accumulated payroll contributions to purchase shares in the Company.

16. The Plan was amended in July 2005, such that effective from 1 November 2005, shares are purchased at the end of specified periods with the purchase price being 85% of the fair market value of the shares at the end of the specified period.

17. Shares purchased by the Plan Administrator are allocated to the account of the participating employee. Once allocated the participating employee may sell their shares through the Plan Administrator at any time. Where they wish to transfer their shares from the account, the participating employee must first satisfy any holding period specified under the Plan.

18. Shares purchased under the Plan have the same rights and privileges as the Company's common stock, including voting and dividend rights.

19. A participating employee's entitlement to purchase shares under the Plan may be terminated in specified circumstances, including where the participating employee terminates their employment prior to the end of the specified period.

20. A participating employee will not be able to hold a legal or beneficial interest in more than 5% of the shares of the Company. Also, at no time will they be in a position to cast or control the casting of more than 5% of the maximum number of votes at a general meeting of the Company.

21. A participating employee's entitlement to acquire shares under the Plan is not transferable and is granted for no consideration.

22. The entitlements to acquire shares under the Plan are not listed for quotation on any stock exchange.

23. At the end of each specified period, no participating employee is entitled to purchase more than 5,000 shares with their accumulated payroll deductions.

24. Whilst the Plan Rules do not provide for participating employees to acquire fractions of shares, the applicant advised that the administrative practice adopted by the Company in 2000 at the time the Plan was implemented, allows participating employees to acquire a fraction of a share in the Company which is a company incorporated in the USA.

Ruling

[All subsequent legislative references are to the ITAA 1936 unless stated otherwise].

25. Where the Plan Administrator purchases and allocates a share to the account of a participating employee in accordance with the Plan Rules, the participating employee will acquire a qualifying share for the purposes of Division 13A of Part III (Division 13A).

Where an employee makes an election

26. Where the participating employee makes an election under section 139E, the discount given in relation to the share acquired under the Plan will be included in their assessable income in the year of income in which the share is acquired, pursuant to subsection 139B(2). Subsection 139BA(2) will not apply to reduce the amount of the discount included in assessable income.

27. The discount included will be an amount equivalent to the market value of the share at the time of acquisition less any consideration paid or given by the participating employee to acquire the share. The market value of the share at this time will be determined under Subdivision F of Division 13A of Part III (Subdivision F of Division 13A).

28. Where a participating employee is allocated a share under the Plan they will also acquire a share for capital gains tax (CGT) purposes, pursuant to section 109-5 of the ITAA 1997.

29. Where the share is subsequently disposed of by or on behalf of the participating employee, the participating employee will make a capital gain if the capital proceeds from the disposal are more than the cost base of the share. Conversely, a capital loss will arise if the capital proceeds are less than the reduced cost base of the share.

30. In calculating any capital gain or capital loss the first element of the cost base or reduced cost base of a share will be the share's market value at the time it is allocated to the participating employee. The market value of the share at this time will be determined under Subdivision F of Division 13A.

31. Where the share is disposed of 12 months or more after acquisition, any capital gain that results from the disposal will be a discount capital gain.

Where an employee does not make an election

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

33. As a share acquired by a participating employee under the Plan will not have any restriction preventing disposal of the share before a particular time or be subject to forfeiture, the cessation time for the share will be the time when the share is allocated to the participating employee and they acquire the share.

Disposal within 30 days

34. Where the participating employee subsequently disposes of the share in an arm's length transaction at, or within 30 days of the cessation time, the discount included in assessable income at the cessation time will be the amount as calculated under subsection 139CC(3). The discount will be the consideration received on the disposal of the share less any consideration paid by the participating employee to acquire the share.

35. Any capital gain or capital loss made as a consequence of such a disposal will be disregarded in accordance with subsection 130-83(2) of the ITAA 1997.

Disposal after 30 days

36. Where the participating employee does not dispose of the share in an arm's length transaction within 30 days of the cessation time, the discount included in assessable income at the cessation time will be calculated under subsection 139CC(4). The discount will be the market value of the share at cessation time (as determined under Subdivision F of Division 13A) less any consideration paid by the participating employee to acquire the share.

37. Where the share is subsequently disposed of the first element of the cost base, or reduced cost base of the share will be the market value of the share at the cessation time, pursuant to subsection 130-83(3) of the ITAA 1997.

38. Where the share is disposed of 12 months or more after acquisition, any capital gain that results from the disposal will be a discount capital gain.

Explanation

39. Division 13A provides for the taxation treatment of shares and rights acquired under employee share schemes.

Entitlement arising from Enrolment Agreement

40. The expression 'right' as used in Division 13A is not defined, but as 'right' and 'right to acquire a share' are used interchangeably throughout Division 13A, the Commissioner considers that a right should be taken to mean a 'right to acquire a share'.

41. A person will acquire a right for the purposes of Division 13A in several circumstances, including when another person creates the right in that person, pursuant to section 139G.

42. In accordance with the Key Principle in section 139, Division 13A provides for the taxation treatment of shares and rights acquired under employee share schemes by assessing (sometimes concessionally) any discount received from the market value of rights or shares.

43. In regard to rights, the scheme of Division 13A requires in the first instance that the discount received by an employee on the acquisition of a right to acquire a share under an employee share scheme is capable of being calculated at the time of acquisition of such a right.

44. Where the necessary information to enable the calculation of the discount is not available or is not capable of being determined at the time of acquisition of a right which is being considered in terms of Division 13A, then the provisions of Division 13A cannot operate as required. Under these circumstances, the Commissioner considers that as the taxation treatment in accordance with the Key Principle cannot be determined, Division 13A will not apply to such rights.

45. The entitlement that a participating employee receives when they submit an Enrolment Agreement under the Plan is conditional on the dollar value of the contributions the participating employee makes over a specified period and the fair market value of the shares at the beginning or end of the specified period. This means that the number of shares that a participating employee may acquire under the Plan is unknown at the time the entitlement is received as is the price (the exercise price) that will be paid to acquire a share in the Company.

46. Therefore it is concluded, that the entitlement that a participating employee receives under the Plan when they complete an Enrolment Agreement, is not a right for the purposes of Division 13A.

Allocation of shares to a participating employee

47. An employee will acquire a share for the purposes of Division 13A in several circumstances including when a person transfers the share to the employee or the employee otherwise acquires a legal interest in the share from a person, pursuant to section 139G.

48. Thus where the Plan Administrator allocates a share to the account of a participating employee the participating employee will acquire the share for the purposes of Division 13A.

49. An employee will acquire a qualifying share under an employee share scheme for the purposes of Division 13A where the share is acquired by the employee:

- in respect of, or for or relation directly or indirectly to, any employment of the employee;
- the consideration for the acquisition is less than the market value of the share at the time it is acquired;
- the share is not acquired as a result of exercising a 'right' that the employee acquired under an employee share scheme; and
- the share satisfies the six conditions specified in section 139CD.

50. The Plan has been established by the Company as part of its employee incentive strategy, thus a share acquired by a participating employee under the Plan is considered to be acquired by them in respect of, or for or relation directly or indirectly to their employment.

51. Under the Plan, participating employees will pay 85% of the fair market value of shares as at the end of the specified period, that is at the time they acquire the shares for the purposes of Division 13A. Thus the Commissioner accepts that the shares will be acquired for less than their market value, where the market value is determined in accordance with Subdivision F of Division 13A.

52. The initial entitlement received by a participating employee under the Plan is not considered to constitute a 'right' for the purposes of Division 13A, thus the share will not be acquired as a result of exercising a 'right' that the employee acquired under an employee share scheme.

53. The Commissioner accepts that the conditions specified in section 139CD are satisfied, that is:

- a share acquired by a participating employee under the Plan is considered to be acquired under an employee share scheme within the meaning of Division 13A;
- the Company is considered to be a holding company of a participating employee's employer company;
- a share available for acquisition under the Plan is considered to be an ordinary share;
- the Commissioner accepts that at the time a participating employee acquires a share under the Plan at least 75% of the permanent employees of Hewlett-Packard Australia Pty Ltd and HP Financial Services (Australia) Pty Limited were, or at some earlier time had been, entitled to acquire shares under the Plan;
- immediately after the acquisition of a share under the Plan no participating employee held a legal or beneficial interest in more than 5% of the shares; and
- immediately after the acquisition of a share under the Plan no participating employee was 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 the Company.

Thus shares acquired under the Plan will be qualifying shares. Where a participating employee acquires a fraction of a Company share under the Plan the Commissioner accepts that it will also be a qualifying share for the purposes of Division 13A.

Discount in relation to shares

54. Where an employee acquires a share under an employee share scheme the discount given in relation to the share is included in their assessable income pursuant to section 139B. When the discount is included in assessable income depends on whether or not the participating employee makes an election under section 139E.

Where an employee makes an election

55. An employee can elect under section 139E that subsection 139B(2) applies in respect of all shares or rights acquired by them in a year of income. Subsection 139B(2) provides that the discount in relation to a share is included in the employee's assessable income in the year of income in which the share is acquired.

56. As the Plan allows for the disposal of a share within three years of acquisition, the Plan does not satisfy the exemption conditions in section 139CE. Thus, subsection 139BA(2) will not operate to reduce the amount of the discount included in a participating employee's assessable income.

57. The amount of the discount to be included is calculated in accordance with subsection 139CC(2). The discount is the market value of the share at the time it is acquired less any consideration paid by the employee.

58. Subdivision F of Division 13A contains special provisions to determine the market value of a share on a particular day. If the share is quoted on an approved stock exchange on the particular day section 139FA provides that its market value is:

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

If the share is not quoted on an approved stock exchange on that day, the market value of the share is determined under section 139FB.

CGT

59. Where the Plan Administrator allocates a share to a participating employee under the Plan the participating employee becomes the owner of the share and acquires the share for CGT purposes, pursuant to subsection 109-5(1) of the ITAA 1997.

60. Where the participating employee subsequently disposes of the share, CGT event A1 happens in relation to the share and the participating employee makes a capital gain if the capital proceeds from the disposal exceed the cost base of the share. Conversely, a capital loss is made if the reduced cost base exceeds the capital proceeds.

61. As the share is acquired at a discount under an employee share scheme the first element of the cost base or reduced cost base of the share is its market value (as determined under Subdivision F of Division 13A) at the time the share was allocated to the participating employee, pursuant to subsection 130-80(2) of the ITAA 1997.

Discount capital gain

62. Under section 115-5 of the ITAA 1997, a capital gain will be a discount capital gain if:

- (a) it is made by an individual, trust, or complying superannuation fund (refer to section 115-10 of the ITAA 1997);
- (b) it is made from a CGT event occurring after 21 September 1999 (refer to section 115-15 of the ITAA 1997);
- (c) the cost base elements have not been indexed (refer to section 115-20 of the ITAA 1997); and
- (d) the relevant CGT asset was acquired at least 12 months before the CGT event (refer to section 115-25 of the ITAA 1997).

63. Where a participating employee acquires a share under the Plan, conditions (a) to (c) above will be satisfied by the participating employee in relation to the share.

64. Further, where a participating employee holds the share for at least 12 months from the time it was first allocated to the participating employee, any gain made on the disposal of the share by or on behalf of the participating employee will be a discount capital gain for the purposes of Division 115 of the ITAA 1997.

Where an employee does not make an election

65. Where an employee acquires a qualifying share and does not make an election under section 139E in respect of the year of income in which the share is acquired, the discount given in relation to the share is included in their assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

66. Where the share acquired has no restrictions preventing disposal of the share before a particular time or any conditions that could result in the employee forfeiting the share, the cessation time for the share will be the time when the employee acquires the share, pursuant to subsection 139CA(1).

67. The amount of the discount to be included in the employee's assessable income is determined under section 139CC and will depend on whether the share is disposed of in an arm's length transaction within 30 days of the cessation time.

Disposal within 30 days

68. Subsection 139CC(3) provides that where an employee disposes of a share in an arm's length transaction at, or within 30 days of, the cessation time the discount to be included in assessable income is the amount or value of any consideration received by the employee for the disposal less the amount or value of any consideration paid or given by the employee for the acquisition of the share.

CGT

69. Subsection 130-83(2) of the ITAA 1997 provides that:

- if the share is a qualifying share;
- an election is not made under section 139E; and
- CGT event A1, C2, E1, E2 or E5 happens in relation to the share in an arm's length transaction at, or within 30 days of, the cessation time,

any capital gain or capital loss the employee makes on the happening of the CGT event is disregarded.

70. Therefore, if the share is disposed of in an arm's length transaction at or within 30 days of it being allocated, no capital gain or loss will arise in relation to that share.

Disposal after 30 days

71. Subsection 139CC(4) provides that where the employee does not dispose of a share in an arm's length transaction within 30 days of the cessation time, the discount will be the market value of the share at the cessation time less the amount or value of any consideration paid or given by the employee for the acquisition of the share. The market value of the share at this time is as calculated in paragraph 58.

CGT

72. Where an employee does not make an election under section 139E and does not dispose of the share in an arm's length transaction within 30 days of the cessation time, the first element of the cost base or reduced cost base of the share is the share's market value at the cessation time, pursuant to subsection 130-83(3) of the ITAA 1997. The market value of the share at this time is as calculated in paragraph 58.

73. Where the share is subsequently disposed of, CGT event A1 occurs and the employee will make a capital gain if the capital proceeds from the disposal exceed the cost base of the share, pursuant to subsection 104-10(4) of the ITAA 1997. Conversely the employee will make a capital loss if the reduced cost base of the share exceeds the capital proceeds from the disposal of the share.

74. Where the share is held for at least 12 months from the time it was first acquired by the employee, any gain made on the disposal of the share by or on behalf of the employee, will be a discount capital gain, in accordance with paragraphs 62 to 64.

Detailed contents list

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Related Rulings/Determinations:

CR 2001/1; CR 2005/85; TR 92/1;
TR 92/20; TR 97/16

Subject references:

- employee share schemes

Legislative references:

- TAA 1953 Pt IVAAA
- Copyright Act 1968
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139
- ITAA 1936 139B
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139BA
- ITAA 1936 139BA(2)
- ITAA 1936 139CA
- ITAA 1936 139CA(1)
- ITAA 1936 139CC
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- ITAA 1997 104-10
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- ITAA 1997 109-5(1)
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- ITAA 1997 130-80
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ATO references

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