CR 2005/99 - Income tax: Qantas Deferred Share Plan - 2003/04 Performance Rights Plan Rules

Class Ruling

Income tax: Qantas Deferred Share Plan – 2003/04 Performance Rights Plan Rules

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 laws' 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 139B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 139BA of the ITAA 1936;
- section 139C of the ITAA 1936;
- section 139CB of the ITAA 1936;
- section 139CC of the ITAA 1936;
- section 139CD of the ITAA 1936;
- section 139CE of the ITAA 1936;
- section 139DD of the ITAA 1936;
- section 139E of the ITAA 1936;
- section 139FA of the ITAA 1936;
- section 139FB of the ITAA 1936;
- section 139FC of the ITAA 1936;
- section 139FE of the ITAA 1936
- section 139G of the ITAA 1936;

- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-25 of the ITAA 1997;
- section 109-5 of the ITAA 1997;
- section 109-10 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 112-20 of the ITAA 1997;
- section 115-5 of the ITAA 1997;
- section 115-10 of the ITAA 1997;
- section 115-30 of the ITAA 1997;
- section 115-100 of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- section 130-60 of the ITAA 1997;
- section 130-80 of the ITAA 1997;
- section 130-83 of the ITAA 1997; and
- section 974-75 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is all Australian resident Senior Managers of the Qantas Group (the Group) who participate in the Qantas Deferred Share Plan (DSP) as described in the arrangement part of this Ruling. In this Ruling, a person belonging to this class of persons is referred to as a participating employee. The Group comprises:

- Qantas Airways Limited (Qantas);
- Eastern Australia Airlines Pty Limited; and
- Jetstar Airways Pty Limited.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement 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 22.

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.

Date of effect

8. This Ruling applies to years commencing both before and after its date of issue. 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, this Ruling only applies to the extent that;

- it is not later withdrawn by notice in the *Commonwealth Gazette*;
- it is not taken to be withdrawn by an inconsistent later Public Ruling; or
- the relevant taxation laws are not amended.

Arrangement

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

- the application for Class Ruling dated 21 April 2005;
- Qantas Deferred Share Plan Terms and Conditions (DSP Terms and Conditions);
- Qantas Deferred Share Plan – 2003/04 Performance Rights Plan Rules (DSP Rules); and
- Correspondence from Qantas Airways Limited dated 8 July 2005.

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.

10. The DSP was established as part of the employee share plan strategy of the Qantas Group and provides a platform for a broader based delivery of equity ownership to employees.

11. The DSP commenced on 17 October 2002.

12. Under the Terms and Conditions of the DSP the Board may from time to time offer shares or grant rights to an eligible employee subject to such conditions as it determines.

13. The DSP Rules provide for DSP rights to be offered to Senior Managers of the Group. The DSP rights are granted to the participating employee.

14. The applicant has advised that the DSP rights granted to the participating employees under the DSP are qualifying rights for the purposes of section 139CD of the ITAA 1936.

15. The participating employees pay no consideration to acquire the DSP rights.

16. The DSP rights are personal to the participating employee and cannot be transferred, assigned or sold.

17. A performance hurdle described in the DSP Rules must be met prior to the vesting of the DSP rights. The performance hurdle covers a three year period.

18. Provided a DSP right has not lapsed it will vest after the performance hurdle has been tested and achieved.

19. DSP rights which vest will automatically be converted to shares. These shares will be acquired on-market by Qantas at no cost to the participating employees.

20. DSP rights lapse:

a) if the participating employee ceases employment with the Group. (This rule does not apply where the participant is employed by the Group at 30 June 2006 but ceases employment with the Group prior to testing); or

b) if the performance hurdle is not achieved after being tested by the Board.

21. Unless the Board otherwise determines, when a DSP right lapses all rights of the participating employee under the DSP in relation to the DSP right cease and no consideration or compensation will be payable for, or in relation to, that lapse.

22. The applicant states that the Rules do not satisfy the exemption conditions in section 139CE of the ITAA 1936 and therefore subsection 139BA(2) of the ITAA 1936 will not apply to reduce the discount included in assessable income.

Ruling

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

23. A right acquired under the DSP will be a right acquired under an employee share scheme and will be a qualifying right for the purposes of section 139CD. For the purposes of Division 13A a DSP right is acquired by a participating employee at the time the DSP right is granted.

24. A share acquired by a participating employee as result of exercising a DSP right will not be a share acquired under an employee share scheme, pursuant to subsection 139C(4). The share will be acquired by the participating employee at the time it is allotted or transferred to them.

Where an employee makes an election

25. Where a participating employee makes an election under section 139E, the discount given in relation to the DSP rights acquired is included in the participating employee's assessable income in the year of income in which the DSP right is acquired, pursuant to subsection 139B(2).

26. The discount included in the participating employee's assessable income will be an amount equivalent to the market value of the DSP right at the time of acquisition, as no consideration is paid or given by the participating employee to acquire the DSP right, pursuant to subsection 139CC(2).

27. Subsection 139BA(2) will not apply to reduce the discount included in the participating employee's assessable income.

Capital gains tax

28. A DSP right will be acquired by a participating employee for capital gains tax (CGT) purposes at the time the DSP right is granted. For the purposes of CGT, the DSP right is a convertible interest.

29. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

30. Where a share acquired as a result of the conversion of the DSP right is disposed of by the participating employee a capital gain will arise where the capital proceeds from the disposal are more than the cost base of the share. Pursuant to subsection 130-60(1) of the ITAA 1997 the first element of the cost base or reduced cost base of the share will be the cost base of the DSP right at the time of the conversion.

31. Where the disposal of the share acquired as a result of conversion of the DSP right occurs 12 months or more after the date of acquisition of the share, any capital gain that results from the disposal will be a discount capital gain subject to meeting the requirements of Subdivision 115-A of the ITAA 1997.

Rights lapse

32. Where a participating employee acquires a DSP right and it lapses without having been exercised section 139DD applies to treat the DSP right as never having been acquired. The amount of the discount will be excluded from the participating employee's assessable income.

33. The participating employee will not make a capital gain or capital loss in relation to the DSP right lapsing.

34. Where the conditions under section 139DD apply, subsection 139DD(4) provides that the assessable discount can be excluded from the participating employees assessment at any time.

Where an employee does not make an election

35. Where a participating employee has not made an election under section 139E, the discount given in relation to a DSP right will be included in the participating employee's assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

36. The cessation time will be the earlier of:

- the time when the participating employee disposes of the DSP right (other than by exercising it);
- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2);
- the time the DSP right is exercised; and
- the end of the 10 year period starting when the participating employee acquired the right.

Disposal within 30 days of cessation time

37. Where a DSP right is exercised and the participating employee disposes of the share acquired as a result of the DSP right being exercised, in an arm's length transaction at, or within 30 days of the cessation time, the discount on the DSP right is calculated under subsection 139CC(3). The discount assessable to the participating employee will be the amount of consideration received on disposal of the share, as no amount is paid to acquire or exercise the DSP right.

Capital gains tax

38. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right within 30 days of the cessation time is disregarded pursuant to subsection 130-83(2) of the ITAA 1997.

39. Any capital gain or capital loss made as a consequence of an arm's length disposal within 30 days of the cessation time of a share acquired as a result of the conversion of the DSP right will be disregarded, pursuant to subsection 130-83(2) of the ITAA 1997.

Disposal after 30 days of cessation time

40. Where the cessation time occurs on exercise of the DSP right and the share acquired as a result of the exercise of the right is disposed of by the participating employee more than 30 days after the cessation time, or in a non-arm's length transaction, the discount on the DSP right is calculated under subsection 139CC(4). The discount assessable to the participating employee will be the market value of the share acquired at the cessation time, calculated in accordance with section 139FA, as no amount is paid to exercise the DSP right.

41. If the DSP right is exercised after the cessation time and the share acquired as a result of the exercise of the right is disposed of by the participating employee more than 30 days after the cessation time, or in a non-arm's length transaction, the discount assessable to the participating employee will be the market value of the right at the cessation time.

Capital gains tax

42. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right more than 30 days after the cessation time is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

43. Where a participating employee disposes of the share acquired as result of the conversion of the DSP right more than 30 days after the cessation time, or in a non-arm's length transaction, a capital gain or capital loss may arise pursuant to subsection 104-10(4) of the ITAA 1997.

44. The first element of the cost base of the share acquired as a result of the conversion of the DSP right will be the cost base of the DSP right at the time of conversion pursuant to subsection 130-60(1) of the ITAA 1997.

45. Where any share acquired as a result of the conversion of the DSP right is disposed of 12 months or more after acquisition of the share, any capital gain that results from the disposal will be a discount capital gain subject to meeting the requirements of Subdivision 115-A of the ITAA 1997.

Rights lapse

46. Where a DSP right, in respect of which no section 139E election has been made, lapses and triggers the cessation time no amount is included in assessable income under subsection 139B(3).

47. The participating employee will not make a capital gain or capital loss in relation to the DSP right lapsing.

Explanation

48. A right will be acquired under an employee share scheme, pursuant to Division 13A, if it is:

- acquired within the meaning of section 139G;
- acquired in respect of the employment of an employee pursuant to subsection 139C(1); and
- acquired for less than the market value and therefore not excluded under subsection 139C(3).

49. Section 139G provides that a person will acquire a right in several circumstances, including when another person creates the right in the employee or they acquire a legal interest in the right from another person.

50. For the purposes of this Ruling, the Commissioner accepts the statement by the applicant that rights acquired under the DSP are qualifying rights for the purposes of section 139CD. Thus, a participating employee will acquire a qualifying right when it is granted.

51. The DSP was established as part of the employee share scheme strategy of the Qantas group and provides a platform for a broader based delivery of equity ownership to employees. As such, any DSP right acquired is considered to be acquired by a participating employee in respect of their employment.

52. As no consideration is paid or given by a participating employee to acquire the DSP right, the participating employee will not acquire the DSP right for market value.

53. Where a participating employee acquires a DSP right the discount given in relation to the DSP right is included in the assessable income of the participating employee, pursuant to subsection 139B(1).

54. As the DSP right is a qualifying right the year of income in which the discount is included in the participating employee's assessable income and the amount of the discount depend on whether the participating employee has made a section 139E election in relation to the acquisition of the DSP right.

Where an employee makes an election

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

56. The amount of the discount to be included in the participating employee's assessable income is calculated in accordance with subsection 139CC(2). The discount is the market value of the DSP right at the time it was acquired by the participating employee less any consideration (if any) paid or given by the participating employee for the acquisition of the right.

57. Subdivision F of Division 13A contains special provisions to determine the market value of a right on a particular day. As the DSP right will not be quoted on an approved stock exchange, the market value of the DSP right will be determined in accordance with section 139FC or section 139FE.

58. As the DSP right has a nil exercise price, the market value of the DSP right is determined pursuant to subsection 139FE(1) and will be equal to the market value (determined under section 139FA) of a Qantas share on the day the DSP right was granted.

59. As Qantas shares are listed on the Australian Stock Exchange (ASX), section 139FA provides that their market value will be:

- 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;
- 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.

60. Where an employee makes an election under section 139E and the exemption conditions in section 139CE are satisfied in relation to the right, subsection 139BA(2) will apply to reduce the discount included in assessable income by up to $1,000.

61. Qantas has stated that the exemption conditions in section 139CE are not satisfied in relation to a DSP right and as such subsection 139BA(2) does not apply.

Capital gains tax

62. The participating employee will acquire a CGT asset, pursuant to subsection 109-5 of the ITAA 1997, at the time a DSP right is granted. For the purposes of CGT the DSP right is a convertible interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997.

63. Pursuant to subsection 130-80(2) of the ITAA 1997, the first element of the cost base of the DSP right will be the market value of the DSP right worked out under sections 139FA to 139FF at the time the participating employee acquires the DSP right.

64. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

65. A DSP right will be converted when the DSP right vests as a result of the performance hurdle having been met and the DSP right being automatically converted to a share by Qantas.

66. A capital gain or capital loss may arise on the disposal of the share acquired as a result of the conversion of the DSP right, pursuant to subsection 104-10(4) of the ITAA 1997.

67. Where shares are allotted or transferred to a participating employee as a result of a DSP right being converted the participating employee will acquire a CGT asset at that time, pursuant to subsections 109-5 and 109-10 of the ITAA 1997.

68. Where the participating employee disposes of a share acquired as a result of conversion of the DSP right, a capital gain will arise pursuant to subsection 104-10(4) of the ITAA 1997, if the capital proceeds from the disposal of the share exceed the cost base of the share. A capital loss will arise if the reduced cost base exceeds the capital proceeds received.

69. The first element of the cost base of the share will be the cost base of the DSP right at the time of conversion, pursuant to subsection 130-60(1) of the ITAA 1997.

70. Where the participating employee disposes of a share acquired as a result of the conversion of the DSP right, any capital gain arising from the disposal will be a discount capital gain if it satisfies the requirements of Subdivision 115-A of the ITAA 1997.

71. Pursuant to subsection 115-25(1) of the ITAA 1997, any capital gain the participating employee makes on the disposal of the share acquired as a result of the conversion of the DSP right will be a discount capital gain if the disposal of the share occurs 12 months or more after acquisition of the share. The discount percentage for the participating employee will be 50%, pursuant to section 115-100 of the ITAA 1997.

Where an employee does not make an election

72. Where a participating employee acquires a DSP right and does not make an election under section 139E, the discount given in relation to the DSP right is included in the participating employee's assessable income in the year of income in which the cessation time occurs, pursuant to subsection 139B(3).

73. The cessation time is determined in accordance with subsection 139CB(1). As the share acquired by a participating employee (as a result of exercising a right acquired under the DSP) is not subject to disposal restrictions, nor subject to forfeiture, the cessation time will be the earlier of:

- the time when the participating employee disposes of the right (other than by exercising it);
- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2);
- the time when the participating employee exercises the right; and
- the end of the 10 year period starting when the participating employee acquired the right.

74. The exercising of the DSP right when it vests as a result of the performance hurdle having been met and the DSP right being automatically converted to a share by Qantas will be a cessation time.

75. A cessation time will also occur where a participating employee ceases employment with the Group after 30 June 2006 but prior to testing of the performance hurdle.

76. The amount of the discount to be included in a participating employee's assessable income is determined under section 139CC and will depend on whether the right, or any share acquired as a result of the exercise of the right, is disposed of in a non-arm's length transaction within 30 days of the cessation time.

Disposal within 30 days

77. Where a participating employee disposes of a share acquired as a result of the exercise of the DSP right, in an arm's length transaction within 30 days of the cessation time, the discount to be included in assessable income is determined in accordance with subsection 139CC(3).

78. Where a participating employee exercises the DSP right and disposes of the share acquired as a result of the exercise of the right, the discount will be the amount or value of any consideration they receive for the disposal of the share less the amount of any consideration they have paid or given to acquire or exercise the right.

79. As the participating employee does not pay any consideration to acquire the DSP right or to exercise that right the discount to be included in the participating employee's assessable income will be the value of the shares received in consideration for the disposal of the DSP right.

Capital gains tax

80. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right within 30 days of the cessation time is disregarded pursuant to subsection 130-83(2) of the ITAA 1997.

81. Any capital gain or capital loss made as a consequence of an arm's length disposal within 30 days of the cessation time of a share, acquired as a result of the conversion of the DSP right, is disregarded pursuant to subsection 130-83(2) of the ITAA 1997.

Disposal after 30 days

82. Where the cessation time occurs on exercise of the DSP right and the share acquired as a result of the exercise of the right is not disposed of by the participating employee at, or within, 30 days of the cessation time, or is disposed of in a non-arm's length transaction, the discount on the DSP right will be the market value of the share at the cessation time (see paragraphs 56 and 57 of this Ruling).

83. Where a DSP right is exercised after the cessation and any share acquired as a result of the exercise of the right is not disposed of at, or within 30 days of the cessation time, or in a non-arm's length transaction, the discount in respect of the DSP right is determined under subsection 139CC(4) of the ITAA 1936.

84. The amount of the discount will the market value of the DSP right at the cessation time less the amount of any consideration they have paid or given to acquire or exercise the right. As the participating employee does not pay any consideration to acquire the DSP right the discount will be the market value of the DSP right at the cessation.

85. The market value of the DSP right is calculated pursuant to Subdivision F of Division 13A. As the DSP rights have a nil exercise price the market value of the DSP right will be equal to the market value of the shares acquired, calculated in accordance with section 139FA (see paragraphs 57-59 of this Ruling).

Capital gains tax

86. Any capital gain or capital loss made by the participating employee on the conversion of a DSP right more than 30 days after the cessation time is disregarded pursuant to subsection 130-60(3) of the ITAA 1997.

87. Where a participating employee disposes of a share acquired as a result of the conversion of a DSP right a capital gain or capital loss may arise (see paragraphs 68-71 of this Ruling).

88. Pursuant to subsection 130-60(1) of the ITAA 1997, the first element of the cost base of the share acquired as a result of the conversion of the DSP right will be the cost base of the DSP right at the time of conversion. Pursuant to subsection 130-83(3) of the ITAA 1997, the first element of the cost base of the DSP right will be the market value of the DSP right worked out under sections 139FA to 139FF at the cessation time.

Where rights lapse

89. The lapse of a participating employee's DSP right in accordance with the DSP Rules will constitute the ending of an intangible CGT asset (CGT event C2). Thus, pursuant to subsection 104-25(3) of the ITAA 1997, the participating employee may make a capital gain or a capital loss on the lapse of a DSP right.

90. However, as the participating employee's lapsed DSP right is deemed never to have been acquired for the purposes of Division 13A (pursuant to section 139DD) Subdivision 130-D of the ITAA 1997 has no application and any capital gain or capital loss is determined under Part 3-1 of the ITAA 1997.

91. The first element of the cost base of the DSP right will be nil as a participating employee does not provide any consideration for the acquisition of the DSP right. The market value substitution rule has no application, pursuant to Item 5 in the table in subsection 112-20(3) of the ITAA 1997.

92. Whilst a participating employee will not receive any capital proceeds from the lapse of the DSP right, the market value substitution rule will not apply as it is accepted that the lapse of the DSP right (in accordance with the DSP Rules) constitutes an ending by expiry, pursuant to subsection 116-30(3) of the ITAA 1997.

93. As such a participating employee will not make a capital gain or capital loss where a DSP right lapses in accordance with the DSP Rules.

Detailed contents list

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

Commissioner of Taxation
16 November 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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

Subject references:

- acquisition of shares
- capital gains tax
- CGT cost base
- CGT discount
- CGT events
- cost base
- dismissal of employees
- disposal of shares
- employee share ownership
- employee share schemes & options
- employees
- forfeiture of rights & entitlements
- income
- resignation of employees
- share discounts on employee share schemes
- shareholders
- shares

Legislative references:

- TAA 1953 Pt IVAAA
- Copyright Act 1968
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B(1)
- 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 139C(4)
- ITAA 1936 139CB
- ITAA 1936 139CB(1)
- ITAA 1936 139CB(2)
- ITAA 1936 139CC
- ITAA 1936 139CC(2)
- ITAA 1936 139CC(3)
- ITAA 1936 139CC(4)
- ITAA 1936 139CD
- ITAA 1936 139CE
- ITAA 1936 139DD
- ITAA 1936 139DD(4)
- ITAA 1936 139E
- ITAA 1936 Pt III Div 13A Subdiv F
- ITAA 1936 139FA
- ITAA 1936 139FB
- ITAA 1936 139FC
- ITAA 1936 139FD
- ITAA 1936 139FE
- ITAA 1936 139FE(1)
- ITAA 1936 139FF
- ITAA 1936 139G
- ITAA 1997 Pt 3-1
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 109-5
- ITAA 1997 109-10
- ITAA 1997 110-25
- ITAA 1997 110-55
- ITAA 1997 112-20
- ITAA 1997 112-20(3)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-5
- ITAA 1997 115-10
- ITAA 1997 115-25(1)
- ITAA 1997 115-30
- ITAA 1997 115-100
- ITAA 1997 116-30
- ITAA 1997 116-30(3)
- ITAA 1997 130-60
- ITAA 1997 130-60(1)
- ITAA 1997 130-60(3)
- ITAA 1997 Subdiv 130-D
- ITAA 1997 130-80
- ITAA 1997 130-80(2)
- ITAA 1997 130-83
- ITAA 1997 130-83(2)
- ITAA 1997 130-83(3)
- ITAA 1997 974-75
- ITAA 1997 974-75(1)

ATO references

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