CR 2006/126 - Income tax: Shell Group - Employee Performance Share Plan

Class Ruling

Income tax: Shell Group – Employee Performance Share Plan

Contents Para

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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

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 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 23AG of the ITAA 1936;
- section 139B 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 139DD of the ITAA 1936;
- section 139E of the ITAA 1936;

- section 139G of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 109-5 of the ITAA 1997;
- section 112-20 of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- section 130-60 of the ITAA 1997;
- section 130-83 of the ITAA 1997;
- section 974-75 of the ITAA 1997; and
- section 995-1 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is all persons who are granted an award under the Royal Dutch Shell plc (RDS) Performance Share Plan (the Plan) while employed in Australia by a company in the Shell group of international companies (the Shell group). Where such persons do not decline an award (as described in paragraphs 15 and 16 of this Ruling), they:

- are residents of Australia (within the meaning of subsection 6(1)); and
- are not temporary residents (within the meaning of subsection 995-1(1) of the ITAA 1997),

from the time the award is granted until the time the award lapses or is satisfied. In this Ruling a person belonging to this class of entities is referred to as a participating employee.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme 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 12 to 30 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

8. This Ruling applies from the income year ended 30 June 2006. 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 the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

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

- The request for Class Ruling (CR8) from Allens Arthur Robinson (AAR) dated 26 April 2006;
- Annexure A – Rules of the Performance Share Plan (the Plan rules);
- Annexure B – Performance Share Plan Award Certificate (the Award certificate);
- The email from AAR dated 24 July 2006; and
- The email from AAR dated 17 November 2006.

13. The Shell group operates a number of employee option and share plans including the Plan.

Grant of an award

14. Under the Plan, eligible Shell group employees are granted an award over a specified number of RDS shares (Shares).

15. The applicant has advised that eligible employees working in Australia will be notified of their award, by either:

- a letter from the HR General Manager, Australia & New Zealand (letter of notice) with an Award certificate attached. The Award certificate specifies a date by which an eligible employee may decline acceptance of the award (this date has subsequently been extended); or
- (from the 1 January 2007), an email from the share plan mailbox (email notification) with a link to an Award certificate. The Award certificate will specify a date by which an eligible employee may decline acceptance of the award (being the last day of the period specified in the Award certificate within which an award may be declined). The date by which an award may be declined may be extended if unforeseen events occur.

16. Where the award is not declined by the date specified in the Award certificate or by the extended date (as the case may be), acceptance of the award by an eligible employee on the date on the letter of notice, or the date of the email notification, is presumed and the eligible employee then becomes a participant in the Plan on that date.

17. Awards granted under the Plan are subject to:

- terms and conditions specified in the Award certificate and in the Plan rules. The Award certificate provides that the terms and conditions set out in the Award certificate prevail over the terms and conditions specified in the Plan rules; and
- performance conditions which are measured over a specified period.

Performance conditions

18. The performance conditions are based on the total shareholder return (TSR) achieved by the Shell group relative to its four main competitors measured over a specified period.

19. Where the Shell group's TSR as measured over the specified period relative to its main competitors:

Ranks 1st	200% of the award will vest
Ranks 2nd	150% of the award will vest
Ranks 3rd	80% of the award will vest
Ranks 4th or 5th	no part of the award will vest

20. To the extent that the performance conditions are satisfied, awards will vest and the Plan rules provide for participants to receive Shares or a cash equivalent. Whilst the Plan rules provide for awards to be satisfied by the payment of a cash amount, the Award certificate provides that a participating employee will only ever receive Shares, except where the delivery of Shares is prohibited by law.

21. To the extent that the performance conditions are not satisfied, an award will not vest and a participating employee's entitlement to Shares will lapse.

Dividend equivalent entitlement

22. Whilst a participating employee is not entitled to receive any dividends in respect of an unvested award, the Plan provides for a participating employee to acquire additional Shares (the Dividend equivalent entitlement) at the vesting time to the extent that the award vests (that is, the Shell group's TSR ranks 3rd or above).

23. The number of additional Shares to which a participating employee becomes entitled, is calculated by reference to:

- the amount of any dividends that the participating employee would have been entitled to receive had they held their vested Shares over the vesting period (assuming full dividend reinvestment); and
- the market value of the Shares as at the date the dividends are declared.

24. Where the award is made before 1 January 2007, the total number of additional Shares is subject to a cap which limits the combined number of Shares and additional Shares to 250% of the number of Shares specified in the award.

25. The cap does not apply to awards made after 1 January 2007.

26. The applicant has advised that, in respect of awards made prior to 1 January 2007, a participating employee can reasonably expect that any entitlement to receive additional Shares in respect of the Dividend equivalent entitlement is likely to be less than the cap. Consequently, the entitlement to such additional Shares is unlikely to be reduced by the cap.

27. The applicant has advised that:

- awards granted under the Plan are granted in respect of employment;
- a participating employee is not required to pay anything for either the grant of the award or on the vesting of the award;
- awards granted under the Plan entitle a participating employee to receive ordinary shares in RDS;
- immediately after the grant of an award, no participating employee will hold a legal or beneficial interest in more than 5% of the shares in RDS or will be 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 RDS.

28. If a participating employee ceases employment with the Shell group prior to vesting:

- the award will lapse at that time unless the cessation is a result of certain events such as injury, retirement or redundancy; or
- the award will (subject to certain exceptions) vest on the date of cessation of employment to the extent the performance conditions are satisfied up to the date of cessation of employment and lapse as to the balance, if employment ceases because of the divestment of a member of the Shell group.

29. A participating employee may work offshore for the Shell group during the vesting period of an award.

30. In accordance with the Plan rules:

- an award cannot be transferred other than where a participating employee ceases employment as a result of death;

- upon vesting, Shares will be issued or transferred to the participating employee within 45 days of vesting; and
- an award will either lapse or be satisfied within 10 years of being granted.

Ruling

31. Where under the Plan, a participating employee is granted an award and they do not decline the award by the date specified in the Award certificate or the extended date (as the case may be), they will acquire a qualifying right for the purposes of Division 13A of Part III (Division 13A) at the time of acceptance of their award in accordance with paragraph 16 of this Ruling.

32. Where the participating employee's award vests and they become entitled to acquire an additional Share pursuant to the Dividend equivalent entitlement, the participating employee will acquire an additional right (for the purposes of Division 13A) at the time the award vests.

33. Where RDS is the employer of the participating employee or the holding company of the employer of the participating employee at the time the award vests, the additional right acquired by a participating employee will be a qualifying right for the purposes of Division 13A.

Acquisition of a convertible interest

34. For the purposes of the capital gains tax (CGT) provisions in Part 3-1 of the ITAA 1997, a participating employee will acquire a convertible interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997 when they are granted an award under the Plan (that is when they are notified of their award).

35. Where the participating employee becomes entitled to receive an additional Share pursuant to the Dividend equivalent entitlement, they will acquire an additional convertible interest at the time the award vests.

Where an award is declined

36. Where a participating employee declines the award by the date specified in the Award certificate or the extended date (as the case may be) they will not acquire a right under an employee share scheme for the purpose of Division 13A nor will they acquire a convertible interest for CGT purposes.

Where employee works offshore during vesting period

37. Where a participating employee works offshore for the Shell group during the vesting period of an award, for a continuous period of 91 days or more, section 23AG may apply to exempt from tax some part of the discount on the right acquired under the Plan that would otherwise be assessable to the participating employee under Division 13A.

38. All subsequent references in this Ruling or the Explanation (Appendix 1), to amounts assessable to a participating employee under Division 13A are subject to the possible application of section 23AG in appropriate circumstances.

Where not employed at time of vesting

39. Where a participating employee is not employed in the Shell group when their award vests, the additional rights they acquire when the award vests are not qualifying rights for the purposes of Division 13A. Therefore, the discount in respect of the additional rights (the market value of the rights at the vesting time) is included in their assessable income in the year the award vests.

Where an election is made

40. Where a participating employee makes an election under section 139E in respect of a qualifying right, the discount given in relation to the right is included in their assessable income in the year they acquire the right. The amount of the discount will be the market value (determined under Division 13A) at the time they acquire the right.

Capital gains tax

41. For the purposes of the CGT provisions in Part 3-3 of the ITAA 1997:

- any capital gain or capital loss that arises on the exercise of the right (the conversion of the right into a Share) is disregarded;
- the participating employee will acquire the Share when the right is exercised by the issue or transfer to them of the Share; and
- the first element of the cost base of the Share will be the market value of the right (determined under Division 13A) at the time of receipt.

Lapse of rights

42. To the extent that the performance conditions are not satisfied or a participating employee ceases employment, and the participating employee's right to receive Shares lapses:

- the participating employee will be entitled to excise any amount that was included in their assessable income in respect of that right; and
- for CGT purposes, the first element of the cost base of the lapsed right will be nil and the capital proceeds will be nil.

Where no election is made

43. Where a participating employee does not make an election under section 139E, the discount given in relation to a qualifying right they acquire under the Plan is included in their assessable income in the year of income in which the cessation time occurs.

44. The cessation time will be the earlier of the following:

- when the participating employee ceases employment with the Shell group within the meaning of subsection 139CB(2); or
- when the right is exercised by the issue or transfer of a Share to the participating employee.

Where cessation occurs on ceasing employment

45. Where a participating employee does not make an election under section 139E and on ceasing employment their rights do not lapse:

- where any Shares issued or transferred to them in respect of the rights are disposed of in an arm's length transaction within 30 days of the cessation time, the discount is the amount or value of the consideration they receive for the disposal; or
- where any Shares issued or transferred to them in respect of the rights are not disposed of in an arm's length transaction within 30 days of the cessation time, the discount is the market value of the rights at the cessation time.

46. For CGT purposes:

- any capital gain or capital loss that arises when a Share is issued or transferred to a participating employee, is disregarded;
- any capital gain or capital loss that arises on the disposal of the Share in an arm's length transaction within 30 days of the cessation time is also disregarded; and

- where a Share is not disposed of in an arm's length transaction within 30 days of the cessation time, the first element of the cost base of the Share is the market value of the right at the cessation time.

Where cessation occurs on the issue or transfer of Shares

47. Where a participating employee does not make an election under section 139E and the cessation time occurs on the issue or transfer of Shares to the participating employee:

- where they dispose of the Shares in an arm's length transaction within 30 days of the cessation time, the discount is the amount or value of the consideration they receive for the disposal; or
- where they do not dispose of the Shares in an arm's length transaction within 30 days of the cessation time, the discount is the market value of the Shares at the cessation time.

48. For CGT purposes:

- any capital gain or capital loss that arises when a Share is issued or transferred to a participating employee is disregarded;
- any capital gain or capital loss that arises on the disposal of the Share in an arm's length transaction within 30 days of the cessation time is also disregarded; and
- where a Share is not disposed of in an arm's length transaction within 30 days of the cessation time, the first element of the cost base of the Share is the market value of the Share at the cessation time.

Lapse of rights

49. Where a participating employee does not make an election under section 139E and their rights to acquire Shares lapse without being exercised:

- the participating employee is not required to include in their assessable income any amount in respect of the lapsed rights and to the extent that any amount has been included, the amount can be excised (that is they can request an amended assessment); and
- for CGT purposes, the first element of the cost base of the lapsed right will be nil and the capital proceeds will be nil.

Commissioner of Taxation
20 December 2006

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.

50. An employee will acquire a qualifying right under an employee share scheme for the purposes of Division 13A where that right:

- is a right for the purposes of Division 13A;
- is acquired within the meaning of section 139G;
- is acquired in respect of employment (subsection 139C(1));
- is acquired for less than market value (subsection 139C(3)); and
- satisfies the relevant conditions set out in section 139CD.

51. 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'.

52. Where at the time a right is granted to an employee:

- the employee has a right to acquire a share on the exercise or operation of the right; and
- for the purposes of subsection 139B(2), the amount of the discount in respect of such a right can reasonably be determined,

the Commissioner considers the right to be a right for the purposes of Division 13A.

53. The Commissioner also considers that the exercise of a right does not necessarily require an action or activity by the owner of the right. Thus where upon vesting a right operates to give the owner of the right a share, the Commissioner considers the right to have been exercised for the purposes of Division 13A.

54. The Plan provides for participating employees to receive Shares or a cash equivalent where an award vests, however the Award certificate provides that a participating employee will only ever receive Shares, except where the delivery of Shares is prohibited by law.

55. The Commissioner accepts that at the time a participating employee is granted an award under the Plan, the award will give them the right to be issued with a Share or have a Share transferred to them at the time of exercise or operation of that right. Thus, the right acquired by a participating employee under the Plan will be a right for the purposes of Division 13A where the discount in respect of the right can be reasonably determined at the time the right is acquired.

Awards granted prior to 1 January 2007

56. Where, prior to 1 January 2007 a participating employee is granted an award, they are entitled to receive up to 250% of the number of Shares specified in their award. This entitlement is comprised of two components:

- the award component which is based on the Shell group's performance relative to its competitors; and
- the Dividend equivalent component which is based on the Shell group's performance relative to its competitors, the dividends it pays over the award vesting period and its share price at the time the dividends are declared.

57. With respect to the award component, achieving the number one ranking where 200% of the award will vest, is considered reasonably achievable at the time the award is granted. Thus, the Commissioner considers that the amount of the discount in respect of this component can reasonably be determined at the time the award is granted.

58. With respect to the Dividend equivalent component, whilst the overall maximum number of Shares an employee can receive under the Plan is known (250% of the award), the applicant has advised that a participating employee is unlikely to receive additional (dividend equivalent) Shares up to the overall maximum. That is, the prospect of a participating employee obtaining sufficient additional Shares under the Dividend equivalent entitlement such that they receive the overall maximum is not considered to be reasonably achievable.

59. Thus, the discount in respect of this component cannot reasonably be determined at the time the award is granted. Therefore, the right to acquire shares in respect of the Dividend equivalent entitlement is not considered to constitute a right for the purposes of Division 13A at the time an award is granted.

Awards granted from 1 January 2007

60. With respect to an award granted on or after 1 January 2007, as the award will not be subject to a cap, the number of additional shares a participating employee can receive in respect of the Dividend equivalent entitlement cannot be determined at the time the award is granted. Thus, the right to acquire shares in respect of the Dividend equivalent entitlement is not considered to be a right for the purposes of Division 13A at the time the award is granted.

61. However, at the time an award vests and a participating employee becomes entitled to receive a specific number of additional Shares in respect of the Dividend equivalent entitlement, the discount in respect of these rights can be reasonably determined. Thus, the Commissioner considers that at this time, the rights to receive a specific number of additional shares are rights for the purposes of Division 13A.

Grant of award – acquisition of a right

62. Section 139G provides that a person will acquire a right for the purposes of Division 13A in several circumstances, including when another person creates a right (being a right for the purposes of Division 13A) in the person.

63. Under the Plan, a participating employee is notified by letter or email that they have been granted an award. Unless they decline the award by the date specified in the award or the extended date for declining the award (as the case may be) they are taken to have accepted the award at the time they were notified (that is, the date on the letter of notice or the date of email notification).

64. Where a participating employee is granted an award (subject to paragraph 71 of this Ruling), a right (for the purposes of Division 13A) will be created in the participating employee at the time they are notified of the award. Thus they will acquire this right within the meaning of section 139G at this time.

Dividend equivalent entitlement – acquisition of an additional right

65. With respect to the Dividend equivalent component, where an award vests, additional rights (for the purposes of Division 13A) will be created in the participating employee at this time. The participating employee will acquire these additional rights within the meaning of section 139G at this time.

Qualifying rights

66. The applicant has advised that awards granted under the Plan are granted in respect of employment and that a participating employee is not required to pay anything for either the grant of the award or on the vesting of the award.

67. The Commissioner therefore accepts that where a participating employee is granted an award (subject to paragraph 71 of this Ruling) they will acquire the right at a discount and in respect of employment at the time they are notified of the award.

68. With respect to the additional rights the participating employee acquires when an award vests, the Commissioner considers these additional rights are also acquired at a discount and in respect of employment.

69. Thus, the rights (including the additional rights, but excluding those additional rights acquired by participating employees who ceased employment with the Shell group prior to the vesting of their award) acquired by a participating employee under the Plan will be qualifying rights as the Commissioner accepts that the relevant conditions in section 139CD are satisfied as follows:

- the rights are rights acquired under an employee share scheme;
- RDS is the employer of the participating employees or the holding company of the employer of the participating employee at the time the rights are acquired;
- the rights are rights to acquire ordinary shares in RDS; and
- immediately after the acquisition of the rights, no participating employee holds a legal or beneficial interest in more than 5% of the shares in RDS or is 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 RDS.

Acquisition of a convertible interest

70. For CGT purposes, where an employer creates a contractual or other right in an employee, that employee will acquire a CGT asset, pursuant to subsection 109-5 of the ITAA 1997. A convertible interest in a company is defined in subsection 995-1(1) of the ITAA 1997 to be an interest of the kind referred to in item 4 of the table in subsection 974-75(1). Item 4 of that table relevantly defines a convertible interest as an interest issued by a company that gives its holder a right to be issued with an equity interest in the company or a connected entity of the company. Thus, for CGT purposes a participating employee will acquire a convertible interest (a CGT asset) when they are granted an award (subject to paragraph 72 of this Ruling) under the Plan (that is, when they are notified of their award) and at the time the award vests and they become entitled to additional Shares, pursuant to the Dividend equivalent entitlement.

Where an award is declined

71. Where a participating employee is notified of their award under the Plan, the award may be declined by the date specified in the Award certificate or the extended date (as the case may be). Where the employee declines the award by the date specified, the Commissioner accepts that the employee never acquires a right under the Plan for the purposes of Division 13A.

72. For CGT purposes an employee will acquire a right if they become the owner. Where the employee declines the award by the specified date or the extended date (as the case may be) the Commissioner accepts that no contractual or other right will have been created in the employee. Thus they will not have acquired a convertible interest for CGT purposes.

Where employee works offshore during vesting period

73. Where a participating employee, who is a resident of Australia and not a temporary resident, as described in paragraph 3 of this Ruling, works offshore for the Shell group during the vesting period of an award, for a continuous period of 91 days or more, section 23AG may apply.

74. If section 23AG does apply, such that any income derived from foreign service during a period of at least 91 days, is exempt from income tax, some part of the discount on the right acquired under the Plan that would otherwise be assessable under Division 13A, may also be exempt from income tax under section 23AG.

Where not employed at time of vesting

75. Where at the time an employee acquires a right to acquire a share in a company and the company is not the employer of the employee or a holding company of the employer of the employee, the right will, pursuant to subsection 139CD(3), not be a qualifying right. Thus, where a participating employee is not employed with the Shell group when their award vests, the additional rights they acquire in respect of the Dividend equivalent component will not be qualifying rights. Therefore, the discount in respect of these additional rights will be assessable to the participating employee in the year they acquire the rights (that is the year the award vests), pursuant to subsection 139B(2). The discount will be the market value (determined under section 139FA of Division 13A) of the rights at the acquisition time, pursuant to subsection 139CC(2).

Where an election is made

76. Where an employee acquires a qualifying right, the discount given in relation to the right is included in the employee's assessable income, pursuant to subsection 139B(1).

77. Where the employee elects under section 139E that subsection 139B(2) apply in respect of all shares and rights acquired by the employee in a year of income, the discount in respect of the rights acquired by the employee will be included in their assessable income in the year of income in which the rights are acquired.

78. The amount of the discount is calculated in accordance with subsection 139CC(2) and is the market value of the rights at the time they were acquired by the employee less any consideration paid or given by the employee for the acquisition of the rights. As the participating employee is not required to pay or give any consideration for the rights, the discount will be the market value of the rights when they are acquired. The market value will be the amount determined under Subdivision F of Division 13A.

Capital gains tax

79. For the purposes of the CGT provisions in Part 3-3 of the ITAA 1997:

- any capital gain or capital loss that arises on the exercise of the right (the conversion of the right into a Share) is disregarded pursuant to subsection 130-60(3) of the ITAA 1997;
- the participating employee will acquire the Share when the right is exercised by the issue or transfer to them of the Share pursuant to subsection 130-60(2) of the ITAA 1997; and
- the first element of the cost base of the Share will be the market value of the right (determined under Division 13A) at the time of receipt, pursuant to subsection 130-80(2) of the ITAA 1997.

Lapse of rights

80. Where a qualifying right is lost without an employee ever having exercised it, in accordance with section 139DD the right is deemed to have never been acquired for the purposes of Division 13A.

81. Thus, where performance conditions are not satisfied or a participating employee ceases employment, and the participating employee's right to acquire a Share lapses, the discount given in relation to the right will not be included in their assessable income. Where any amount has been included in the participating employee's assessable income under subsection 139B(1) it may be excised at any time by the amendment of an assessment, pursuant to subsection 139DD(4).

82. For CGT purposes, the lapse of a right 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 the right.

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

84. The first element of the right's cost base will be nil as a participating employee does not provide any consideration for the acquisition of the right. The market value substitution rule for cost base modifications has no application, pursuant to item 5 in the table in subsection 112-20(3) of the ITAA 1997. Whilst a participating employee will not receive any capital proceeds from the lapse of the right, the market value substitution rule for capital proceeds has no application as it is accepted that the lapse of the right constitutes an expiry, pursuant to subsection 116-30(3) of the ITAA 1997. Thus a participating employee will not make a capital gain where a right lapses.

Where no election is made

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

86. The cessation time is determined in accordance with subsection 139CB(1). Because rights granted under the Plan:

- cannot be transferred (other than when a participating employee ceases employment on death);
- will lapse or be satisfied within 10 years of grant; and
- a Share acquired by a participating employee under the Plan is not subject to disposal restrictions, or subject to forfeiture,

the cessation time will be the earlier of:

- the time when the participating employee ceases employment with their employer or a group company, pursuant to subsection 139CB(2); or
- the time when the right is exercised by the issue or transfer of a Share to the participating employee.

87. The amount of the discount 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 an arm's length transaction within 30 days of the cessation time.

Where cessation time occurs on ceasing employment

88. Where on ceasing employment a participating employee's rights do not lapse and any Shares issued or transferred in respect of the rights are disposed of in an arm's length transaction within 30 days of ceasing employment (the cessation time), the discount is the amount or value of the consideration they receive for the disposal, pursuant to subsection 139CC(3).

89. For CGT purposes, any capital gain or capital loss a participating employee makes is disregarded:

- on the conversion (exercise) of the right (a convertible interest) into a Share, pursuant to subsection 130-60(3) of the ITAA 1997; and
- on the disposal of the Share, pursuant to subsection 130-83(2) of the ITAA 1997.

90. Where on ceasing employment, rights do not lapse and the participating employee does not dispose of any Shares issued or transferred to them in respect of the rights in an arm's length transaction within 30 days of the cessation time (ceasing employment), the discount is the market value of the rights at the cessation time, pursuant to subsection 139CC(4). The market value of the rights is determined under Subdivision F of Division 13A.

91. For CGT purposes, any capital gain or capital loss a participating employee makes:

- on the conversion (exercise) of the right (a convertible interest) into a Share, is disregarded pursuant to subsection 130-60(3) of the ITAA 1997; and
- the first element of the cost base of the Share is the market value of the right (as determined under Subdivision F of Division 13A) at the cessation time (ceasing employment) pursuant to subsection 130-83(3) of the ITAA 1997.

Where cessation occurs on the issue or transfer of a Share

92. Where the cessation time occurs on the exercise of a right by the issue or transfer of a Share to the participating employee, and the participating employee disposes of the Share in an arm's length transaction within 30 days of the cessation time, the discount will be determined under subsection 139CC(3). The discount will be the value of any consideration received by the participating employee for the disposal of the Share as no consideration is provided for the right or for the exercise of the right.

93. For CGT purposes, any capital gain or capital loss a participating employee makes is disregarded:

- on the conversion (exercise) of the right (a convertible interest) into a Share, pursuant to subsection 130-60(3) of the ITAA 1997; and
- on the disposal of the Share, pursuant to subsection 130-83(2) of the ITAA 1997.

94. Where the participating employee does not dispose of the Share in an arm's length transaction within 30 days of the cessation time (being the time of exercise of a right by issue or transfer of a Share), the discount will be determined under subsection 139CC(4). The discount will be the market value of the Share acquired on exercise of the right at the cessation time. The market value of the Share is determined under Subdivision F of Division 13A.

95. For CGT purposes, any capital gain or capital loss a participating employee makes:

- on the conversion (exercise) of the right (a convertible interest) into a Share is disregarded, pursuant to section 130-60(3) of the ITAA 1997; and
- the first element of the cost base of the Share is the market value of the right (as determined under Subdivision F of Division 13A) at the cessation time (being the issue or transfer time) pursuant to subsection 130-83(3) of the ITAA 1997.

Lapse of rights

96. Where a qualifying right is lost without an employee ever having exercised it, the right is never acquired for the purposes of Division 13A. Thus, where performance conditions are not satisfied and a participating employee's right to acquire a Share lapses, the discount given in relation to the right will not be included in their assessable income. Where any amount has been included in the participating employee's assessable income under subsection 139B(1) it may be excised at any time by the amendment of an assessment, pursuant to subsection 139DD(4).

97. For CGT purposes, the lapse of a right 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 the right.

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

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

100. Whilst a participating employee will not receive any capital proceeds from the lapse of the right, the market value substitution rule for capital proceeds has no application as it is accepted that the lapse of the right constitutes an expiry, pursuant to subsection 116-30(3) of the ITAA 1997. Thus, a participating employee will not make a capital gain where a right lapses.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2006/54; CR 2006/55;
CR 2006/56

Subject references:

- capital proceeds
- convertible interest
- CGT event C1-C3 - end of a CGT asset
- cost base
- election
- employee share scheme
- no election
- ordinary share
- qualifying right
- resident
- rights
- share
- shareholder

Legislative references:

- ITAA 1936 6
- ITAA 1936 6(1)
- ITAA 1936 23AG
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B
- ITAA 1936 139B(1)
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139C
- ITAA 1936 139C(1)
- ITAA 1936 139C(3)
- 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 139CD(3)
- ITAA 1936 139DD
- ITAA 1936 139DD(4)
- ITAA 1936 139E
- ITAA 1936 Pt III Div 13A Subdiv F
- ITAA 1936 139FA
- ITAA 1936 139G
- ITAA 1997 Pt 3-1
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 109-5
- ITAA 1997 112-20
- ITAA 1997 112-20(3)
- ITAA 1997 116-30
- ITAA 1997 116-30(3)
- ITAA 1997 Pt 3-3
- ITAA 1997 Subdiv 130-D
- ITAA 1997 130-60
- ITAA 1997 130-60(2)
- ITAA 1997 130-60(3)
- 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)
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- Corporations Act 2001
- Copyright Act 1968
- TAA 1953
- TAA 1953 Sch 1 357-75(1)

ATO references

NO: 2006/25227
ISSN: 1445-2014
ATOlaw topic: Income Tax ~~ Assessable income ~~ employee share schemes