

# ***CR 2012/4 - Income tax: Toll Holdings Limited Senior Executive Options and Rights Plan***



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## Class Ruling

### Income tax: Toll Holdings Limited Senior Executive Options and Rights Plan

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#### **ⓘ This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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

## What this Ruling is about

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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 280-100 of Schedule 1 to the *Taxation Administration Act 1953* (TAA);
- Section 280-160 of Schedule 1 to the TAA;
- Division 284 of Schedule 1 to the TAA;
- Subdivision 284-B of Schedule 1 to the TAA;
- Section 284-75 of Schedule 1 to the TAA;
- Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 83A-10 of the ITAA 1997;
- Subdivision 83A-B of the ITAA 1997;
- Section 83A-20 of the ITAA 1997;

- Section 83A-25 of the ITAA 1997;
- Section 83A-35 of the ITAA 1997;
- Subdivision 83A-C of the ITAA 1997;
- Section 83A-105 of the ITAA 1997;
- Section 83A-110 of the ITAA 1997;
- Section 83A-120 of the ITAA 1997;
- Section 83A-330 of the ITAA 1997; and
- Section 83A-340 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

## **Class of entities**

3. The class of entities to which this Ruling applies is employees of Toll Holdings Limited and its subsidiaries (Toll) who:

- accept or are deemed to have accepted an offer to participate in the Senior Executive Options and Rights Plan (Plan); and
- have been or will in the future be granted Options and Rights to acquire fully paid ordinary shares in Toll Holdings Limited under the Plan.

In this Ruling, a person belonging to this class of entities is referred to as a participant.

## **Qualifications**

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 23 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.

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## Date of effect

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8. This Ruling applies from 1 July 2009. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

## Scheme

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9. The following description of the scheme is based on information provided by the applicant in:

- the class ruling application dated 2 August 2011;
- Rules of the SEORP;
- SEORP Offer Guide; and
- Subsequent emails and telephone conversations.

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

10. The operation of the Plan is governed by the Offer Guide and Plan Rules (rules). Reference to the rules is to the versions that were in force at the time Options were granted on 24 February 2010.

11. The Plan is part of Toll's overall remuneration strategy which recognises executives' long term performance and provides for eligible executives as determined by the Board to receive an offer of Options and/or Rights and thus becoming participants and be bound by the rules.

12. A Right is a right to acquire a fully paid ordinary share in Toll Holdings Limited (Restricted Share) at no consideration and with a zero exercise price. The Rights are held subject to the achievement of performance hurdles (unless waived by the Board) and the participants' continued employment with Toll. An Option is the same as a right except that it has an exercise price. Any reference to the Options in this ruling is to both Options and Rights.

13. The performance hurdle for tranche 1 Options compares Toll's Total Shareholder Return (TSR) with the Top 100 companies (Comparator Group) at the beginning of the performance period on 1 January 2010 and at the end of the performance period on 31 December 2012. The change in Toll's TSR is then compared to each of the entities in the Comparator Group over the same test dates and 50% to 100% of Options become exercisable on a sliding scale straight line basis between the 50<sup>th</sup> and 75<sup>th</sup> percentile respectively. Options which do not become exercisable on testing will lapse.

14. The performance hurdle for Tranche 2 Options is based on Toll's Earnings Per Share (EPS Growth) subject to three tests over the performance period commencing on 1 January 2010 and ending on 31 December 2014 and between 50% and 100% of Options become exercisable on a sliding scale if EPS Growth of 10%pa to 15%pa respectively is achieved. Options which do not become exercisable on testing for EPS Growth test over the third test period will lapse.

15. Notwithstanding the performance hurdles being satisfied, the Board has an overriding discretion to determine whether or not and to what extent Participants' Options may be exercised or lapse. Any Options which have not been exercised by the expiry date will automatically expire unless the Board determines otherwise.

16. Where a participant ceases employment with Toll, the Options will generally lapse unless otherwise determined by the Board.

17. Unvested Options lapse if:

- participants resign; retire or are made redundant from the Group;
- participants' employment is terminated due to serious misconduct or because the Board determines that they have committed serious fraud, defalcation, gross misconduct or are in breach of their obligations to Toll; or
- the plan rules otherwise determine so.

18. Unvested Options held by a participant who ceases employment due to 'special circumstances' including death or permanent disability, will not lapse, but remain subject to the performance hurdles.

19. Restricted Shares allocated to participants on exercise of their Options are acquired by the Plan Trustee and held on trust on the participants' behalf until the earlier of the following times:

- 7 years after the Grant Date;
- the Restricted Shares being withdrawn by the participant; or
- forfeiture of the shares.

20. Participants may apply to withdraw all or some of their Restricted Shares from the Plan by completing a notice or withdrawal which is subject to approval by the Board. The applicant has confirmed that the Board will not withhold its approval and there is no restriction on participants disposing of their shares.

21. If a participant's Restricted Shares remain in the Plan after the participant ceases employment, the Shares would continue to be liable to subsequent forfeiture.

22. On forfeiture of Restricted Shares participants will be paid the lower of what they paid to acquire Restricted Shares or the market value of the Restricted Shares at the time, less any amount participants owe Toll.

23. Participants' shares are subject to Toll's Securities Trading Policy.

## **Ruling**

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24. Section 83A-340 applies to Options granted under the Plan if and when those Options become rights to acquire Toll shares at the time that the Board notifies participants that the Options have become exercisable (the vesting time).

25. Where section 83A-340 applies in relation to an Option granted under the plan and subsection 83A-35(9) does not apply to the participant then the discount given in relation to the Option must be included in the assessable income of the participant in the income year in which the Option was acquired under subsection 83A-25(1).

26. Where section 83A-340 applies in relation to an Option granted under the Plan and subsection 83A-35(9) does apply to the participant then the discount given in relation to the Option must be included in the assessable income of the participant in the income year in which the ESS deferred taxing point occurs under section 83A-120.

27. Where a participant has ceased employment (within the meaning of that term in section 83A-330) with Toll prior to the vesting time and subsection 83A-35(9) applies to the participant, then the deferred taxing point will be the time that the participant ceases employment under subsection 83A-120(5) unless subsection 83A-120(3) applies.

28. Where a participant has continued to be employed with Toll up until the vesting time and subsection 83A-35(9) applies to the participant, then the deferred taxing point will be the vesting time under subsection 83A-120(7) unless subsection 83A-120(3) applies.

29. Where a participant's assessment of an earlier income year is amended to include an amount in relation to the Options, no shortfall penalty will be imposed pursuant to Subdivision 284-B of Schedule 1 to the TAA.

30. Where a participant's assessment of an earlier income year is amended to include an amount in relation to the Options, a shortfall interest charge (SIC) on the additional amount of tax that becomes payable will be imposed pursuant to section 280-100 of Schedule 1 to the TAA. However, the participant may request that the Commissioner exercise his discretion under section 280-160 of Schedule 1 to the TAA and remit the SIC in full or in part.

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**Commissioner of Taxation**

18 January 2012

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## Appendix 1 – Explanation

**❶** *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.*

### ESS Interests

31. Under subsection 83A-10(1), an ESS interest in a company is either a beneficial interest in a share in the company, or a right to acquire a beneficial interest in a share in the company.

32. Vesting of the Options granted to participants under the Plan is at the discretion of the Board, subject to performance hurdles being satisfied over a 5 year performance period, commencing at the beginning of the year the Options are granted.

33. Thus, at the time the Options are granted to participants under the Plan, they are both conditional and subject to the exercise of the Board's discretion. In these circumstances the participants are not considered to have acquired a right to acquire shares on grant of the Options.

### Indeterminate Rights

34. Section 83A-340 provides that where you acquire a beneficial interest in a right that later becomes a right to acquire a beneficial interest in a share, Division 83A will apply as if the right had always been a right to acquire the beneficial interest in the share.

35. In order for section 83A-340 to apply:

- the right acquired must be capable of becoming a right to acquire a beneficial interest in a share; and
- the right must become a right to acquire a beneficial interest in a share.

36. Section 83A-340 provides examples of rights which later become rights to acquire a beneficial interest in a share:

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

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

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



37. In both examples the right is a right to receive property but the precise extent or nature of that property has not yet been determined at the time of acquisition of the right. Such rights are capable of becoming a right to acquire a beneficial interest in a share because the capacity to acquire property is inherent in the nature of the right originally acquired. It merely remains to be determined whether the original right ultimately becomes a right to acquire a specific number of shares or some other form of property, such as cash.

38. At the time a participant is granted Options, the right that the participant obtains is a right to acquire a beneficial interest in a share:

- if service conditions and performance hurdles are satisfied; and
- Board does not exercise its overriding discretion (which must be exercised in good faith) to prevent the Options from vesting.

39. Whilst the rights that the participant obtains are the subject of a discretion, the rights which the participant obtains are considered to be rights to property. These rights can be distinguished from the rights that a discretionary beneficiary obtains when they become the object of a discretionary trust.

40. Where the trustee of a discretionary trust has an absolute discretion to apply the income and capital of a trust, the beneficiary's only rights are discrete, fixed and fully determined at the time of grant. As was noted in Class Ruling CR 2011/ 19 the Commissioner considers such rights cannot be indeterminate rights as they are not capable of becoming rights to acquire a beneficial interest in shares.

41. By contrast, where a participant is granted Options under the Plan, the Commissioner considers the rights obtained are rights to property which are capable of becoming rights to acquire beneficial interests in shares.

42. Thus, where Options are granted to a participant and those Options become rights to acquire shares in Toll Holdings Limited section 83A-340 will apply to those Options.

## **Discount to be included in assessable income**

43. Subsection 83A-25(1) in Subdivision 83A-B requires that assessable income for the income year in which an ESS interest is acquired includes the discount in relation to the interest. However, this Subdivision does not apply if Subdivision 83A-C applies.

**Subdivision 83A-C**

44. Subdivision 83A-C provides that where certain conditions are satisfied the discount in relation to an ESS interest in a company is not included in an employee's assessable income when they acquire the interest. Instead the assessable income of the employee will include at a later time (the deferred taxing point) any gain made in relation to the interest up until the deferred taxing point. The conditions to be satisfied are listed at subsection 83A-105(1) are:

- (i) the ESS interest is acquired at a discount under an employee share scheme (paragraph 83A-105(1)(a) and section 83A-20);
- (ii) the Employee is, at that time, employed by the company or a subsidiary of the company (paragraph 83A-105(1)(b) and subsection 83A-35(3));
- (iii) all the ESS interests under the employee share scheme relate to ordinary shares (paragraph 83A-105(1)(b) and subsection 83A-35(4));
- (iv) the predominant business of the company in which the ESS interest is acquired is not the acquisition, sale or holding of shares, securities or other investments or if it is, the employee is not employed by the company and employed by another company that is a subsidiary or holding company of that company, or a subsidiary of the holding company (paragraph 83A-105(1)(b) and subsection 83A-35(5));
- (v) immediately after acquiring the ESS interest, the employee does not hold beneficial interest in more than 5% of the shares in the company or is not 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 (paragraph 83A-105(1)(b) and subsection 83A-35(9));
- (vi) if the ESS interest is a beneficial interest in a right to acquire a beneficial interest in a share, at the time the employee acquired the ESS interest there is a real risk of forfeiting or losing the right (other than by disposing of the right, exercising the right or letting the right lapse) or there is a real risk of forfeiting the underlying share (paragraphs 83A-105(1)(d) and 83A-105(3)(b) ).

## **Real risk of forfeiture**

45. The Explanatory Memorandum (EM) to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, which inserted Division 83A into the ITAA 1997, explains the real risk of forfeiture test at paragraph 1.156 as follows:

The 'real risk of forfeiture test' does not require employers to provide schemes in which their employee share scheme benefits are at a significant or substantial risk of being lost. However, real is regarded as something more than a mere possibility. Something is not a real risk if a reasonable person would disregard the risk as highly unlikely to occur or as nothing more than a rare eventuality or possibility.

46. It is further explained at paragraph 1.158 of the EM that the 'real risk of forfeiture test' is intended to provide for deferral of tax when there is a real alignment of interests between the employee and employer, through the employee's benefits being at risk.

47. A real risk of forfeiture under the Plan is created by the inclusion of performance hurdles that must be satisfied before the Options can be exercised. The Commissioner accepts that a condition of an employee share scheme that imposes such performance hurdles provides more than a 'mere' or 'rare' possibility of forfeiture.

## **Deferred taxing point – Rights to acquire shares**

48. When Subdivision 83A-C applies to an ESS interest, an amount will be included in the assessable income of an employee in accordance with section 83A-110 at the ESS deferred taxing point.

49. Section 83A-120 contains the rules for determining when the 'ESS deferred taxing point' occurs for rights to acquire shares. This will be the earlier of the following times:

- when the participant ceases the employment in respect of which they acquired the rights within the meaning of section 83A-330 (subsection 83A-120(5));
- seven years after the participant acquired the rights (subsection 83A-120(6));
- when there is no real risk of forfeiting the right and the scheme no longer genuinely restricts disposal of the right (subsection 83A-120(4)); or
- when there is no real risk of forfeiting the right or underlying share, and the scheme no longer genuinely restricts exercise of the right or disposal of the resulting share (subsection 83A-120(7)).

50. However, if the participant disposes of the Options (or the Restricted Shares acquired on exercise of the Options) within 30 days of the abovementioned deferred taxing point, the deferred taxing point will instead be the time of disposal (subsection 83A-120(3)).

**Amount to be included in assessable income of SEORP participants**

51. Participants in the Plan will need to include the discount in relation to the Option in their assessable income in the income year in which the deferred taxing point occurs. This may require some participants to request that the Commissioner amend an assessment of an earlier year of income.

52. Where under the Plan a participant is granted Options and subsection 83A-35(9) does not apply to the participant because immediately after acquiring the ESS interests, the participant holds more than 5% of the shares in the company or is 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, then pursuant to subsection 83A-25(1), the discount given in relation to the Option must be included in the assessable income of the participant in the income year in which the Option was acquired.

53. Where under the Plan a participant is granted Options and all the conditions in section 83A-105 are satisfied (see paragraphs 44 – 47), then the discount given in relation to the Option must be included in the assessable income of the participant in the income year in which the deferred taxing point occurs under section 83A-120 (see paragraphs 48-50).

54. Where a participant in the Plan ceases employment with Toll prior to the vesting time and subsection 83A-35(9) applies to the participant because immediately after acquiring the ESS interest, the participant does not hold beneficial interest in more than 5% of the shares in the company or is not 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, then the deferred taxing point will be the time that the participant ceases employment, under subsection 83A-120(5) unless subsection 83A-120(3) applies (see paragraphs 48-50).

55. Where a participant who is granted Options under the Plan has continued to be employed with Toll up until the vesting time and subsection 83A-35(9) applies to the participant, then the deferred taxing point will be the vesting time under subsection 83A-120(7) unless subsection 83A-120(3) applies (see paragraphs 48-50).

**Shortfall penalty and shortfall interest charge**

56. Division 284 of Schedule 1 to the TAA sets out the uniform administrative penalties that apply to entities for failing to satisfy obligations under taxation laws.

57. Subsection 284-75(1) of Schedule 1 to the TAA imposes penalties for false or misleading statements according to an entity's behaviour and actions at the time of and leading up to the making of a statement. Where the entity has taken reasonable care to comply with their tax obligations, no administrative penalty will be imposed under subsection 284-75(1) of Schedule 1 to the TAA.

58. Where a participant's assessment of an earlier income year is amended to include an amount in relation to the Options, no shortfall penalty will be imposed as, at the time of lodgment of the original income tax return, the statement made is not false or misleading.

59. Section 280-100 of Schedule 1 to the TAA imposes SIC on the additional amount of tax that becomes payable as a result of a taxpayer's assessment being amended. This is to compensate the government for the impact of late payments and to ensure that taxpayers with tax shortfalls do not receive an advantage over those who pay the tax properly owing at the appropriate time.

60. The EM, which inserted Division 83A into the ITAA 1997, contemplates SIC applying as stated in the following paragraph:

1.372 The shortfall interest charge may apply in situations where the Commissioner amends an employee's income tax assessment for an earlier income year to include additional amounts of assessable income that result in extra income tax becoming payable.

61. Section 280-160 of Schedule 1 to the TAA provides that SIC may be remitted in full or in part where it is considered to be fair and reasonable to do so.

62. A participant whose assessment of an earlier income year is amended to include an amount in relation to the Options, and a SIC is imposed on the additional amount of tax that becomes payable, may request that the Commissioner exercise his discretion under section 280-160 of Schedule 1 to the TAA and remit the SIC in full or in part.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10; CR 2011/19

*Subject references:*

- employee share scheme
- ESS deferred taxing point
- ESS interest
- real risk of forfeiture

*Legislative references:*

- ITAA 1997 Div 83A
- ITAA 1997 83A-10(1)
- ITAA 1997 Subdiv 83A-B
- ITAA 1997 83A-20
- ITAA 1997 83A-25(1)
- ITAA 1997 83A-35(3)
- ITAA 1997 83A-35(4)
- ITAA 1997 83A-35(5)
- ITAA 1997 83A-35(9)
- ITAA 1997 Subdiv 83A-C
- ITAA 1997 83A-105
- ITAA 1997 83A-105(1)
- ITAA 1997 83A-105(1)(a)
- ITAA 1997 83A-105(1)(b)

- ITAA 1997 83A-105(1)(d)
- ITAA 1997 83A-105(2)
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- ITAA 1997 83A-330
- ITAA 1997 83A-340
- TAA 1953
- TAA 1953 Sch 1 280-100
- TAA 1953 Sch 1 280-160
- TAA 1953 Sch 1 Div 284
- TAA 1953 Sch 1 Subdiv 284-B
- TAA 1953 Sch 1 284-75
- TAA 1953 Sch 1 284-75(1)

*Other references:*

- Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

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ATO references

NO: 1-3DMO7UP

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Assessable income ~~ employee share schemes