CR 2012/60 - Income tax: 2011/12 Qantas Manager Incentive Plan

Class Ruling

Income tax: 2011/12 Qantas Manager Incentive Plan

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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:

- Subdivision 83A-C of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 83A-120 of the ITAA 1997;
- subsection 83A-120(3) of the ITAA 1997;
- section 83A-340 of the ITAA 1997; and
- subsection 130-80(1) 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 Qantas Airways Limited (Qantas) and its subsidiaries, being Eastern Australia Airlines Pty Limited, Jetstar Airways Pty Limited, Sunstate Airlines (Qld) Pty Limited, and Qantas Defence Services Pty Limited (the Qantas Group) who:

- are granted a right under the 2011/12 Qantas Manager Incentive Plan (the Plan) to an award; and
- are residents of Australia within the meaning of that expression in subsection 6(1) of the *Income Tax Assessment Act 1936*.

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 25 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- this Ruling may be withdrawn or modified.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 1 July 2011 to 30 June 2015. The Ruling continues to apply after 30 June 2015 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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

9. The following description of the scheme is based on information provided by Qantas. The following documents, or relevant parts of them form part of and are to be read with the description:

- the request for a Class Ruling from Qantas dated 24 April 2012;
- Qantas Employee Share Plan Trust Deed dated 12 August 2010;
- Qantas Manager Incentive Plan Terms and Conditions – Approved by Qantas Chief Executive Officer (CEO) (under Board delegation) on 12 August 2010 (the Plan Terms);
- 2011/12 Manager Incentive Plan Invitation Letter (the Invitation Letter);
- Qantas Code of Conduct and Ethics (the Code);
- Qantas Employee Share Trading Procedure; and
- correspondence from Qantas providing further particulars.

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

The Plan

10. The Plan provides a means for the delivery of equity ownership to Qantas Group employees. The objectives of the Plan are to, amongst other things, align the interests of executives and shareholders and provide an incentive for the retention of key executives.

The Plan Terms and Invitation Letter

11. The CEO of Qantas sends out Invitation Letters to selected employees of the Qantas Group outlining the following information:

- value of, or the method for determining the value of, the award opportunity (the MIP Award);
- the relevant performance measures applicable to the award;
- the manner in which the award will be delivered should a MIP Award vest that is, Cash Bonus, fully paid ordinary shares in Qantas (MIP Shares) or Deferred Cash Award (or a combination of those);
- any disposal restrictions which attach to the MIP Shares; and
- any other relevant terms and conditions which apply to the MIP Award and/or MIP Shares, including conditions for vesting and forfeiture of any MIP Shares.

12. Employees are deemed to have accepted the MIP Award if contrary action is not taken within 10 business days from issue of the invitation.

13. No consideration is payable by the participant upon the grant or vesting of the MIP Award.

14. Vesting of the MIP Award for each participant is partly subject to Qantas achieving various performance measures (as determined by the CEO) and partly subject to the participant achieving their individual performance objectives (as agreed between the participant and their manager) during the 2011/12 financial year (together the Performance Measures). The participant’s right to the MIP Award will generally vest to the extent that the Performance Measures are achieved.

15. When the participant’s MIP Award vests, a portion of the MIP Award may be delivered as MIP Shares (that are subject to disposal restrictions for a period of time). It is intended that one-third of the total MIP Award will be delivered as MIP Shares, however, this is subject to an overriding discretion of the CEO to vary the form of the vested MIP Award, including to deliver entirely by way of a Cash Bonus or by MIP Shares.

16. MIP Shares allocated to participants will be held on the participants' behalf by the trustee of the Qantas Employee Share Plan Trust until the end of the relevant restriction periods determined by the CEO (Restriction Period). Subject to the CEO's overriding discretion to vary the restriction periods, the Restriction Period is intended to end:

- in relation to one-half of the MIP Shares allocated to a participant – the day after the full-year results are announced in August 2013; and
- in relation to the remainder of the MIP Shares allocated to a participant – the day after the full-year results are announced in August 2014.

17. At the end of each Restriction Period, the Qantas Employee Share Trading Policy as contained in the Code (Qantas Employee Share Trading Policy) may apply to further restrict certain employees (that is, Nominated Qantas Employees) from disposing of their shares.

18. Subject to compliance with the insider trading provisions of the *Corporations Act 2001* Qantas will acquire MIP Shares allocated to participants on-market.

19. Where a participant ceases employment before the CEO determines the extent to which an award vests, the participant will generally not be eligible for payment under the Plan. However, participants who are employed for at least six months of a Performance Period, but cease employment with the Qantas Group by reason of death, disability or other reason with approval of the CEO, may be entitled to a pro-rated amount of the award in the form of a Cash Bonus (after their MIP Award vests).

20. Any MIP Shares which are subject to the Restriction Period will be forfeited if a participant resigns in circumstances not approved by the CEO, is terminated for cause or terminated in other circumstances determined by the CEO as involving unacceptable performance or conduct.

21. When a MIP Share is forfeited, all rights and interests of a participant in respect of that MIP Share immediately cease.

22. At the end of the Restriction Period, a participant may deal with their MIP Shares (subject to the Qantas Employee Share Trading Policy).

23. In the event of a takeover or change of control, and unless the Board of Qantas determines otherwise, MIP Shares will be released from restriction within a specified time following the relevant event.

24. Immediately after the acquisition of the right under the Plan, no participant holds a beneficial interest in more than five per cent of the shares in Qantas and no participant is in a position to cast or control the casting of more than five per cent of the votes that may be cast at a general meeting of Qantas.

25. The predominant business of Qantas is not the acquisition, sale or holding of shares, securities or other investments, whether directly or indirectly through one or more companies, partnerships or trusts.

Ruling

26. A right granted to a participant under the Plan will be an indeterminate right under section 83A-340 to the extent that the right is satisfied by the allocation of MIP Shares.

27. The indeterminate right will be treated as a right to acquire a beneficial interest in shares from the time the MIP Award was granted to the participant.

28. The rights to acquire a beneficial interest in shares are ESS interests acquired under an employee share scheme.

29. The rights acquired by participants under the Plan are at real risk of forfeiture and consequently, Subdivision 83A-C will apply to the ESS interests.

30. The discount given in relation to the MIP Shares will be included in a participant's assessable income at the ESS deferred taxing point provided by section 83A-120.

31. The amount to be included in assessable income will be the market value of the MIP Shares at the ESS deferred taxing point reduced by the cost base of the interest.

32. Where the ESS deferred taxing point occurs before disposal of the MIP Share then for capital gains tax (CGT) purposes:

- the participant is deemed to have acquired, at its market value, the ESS interest (and the MIP Share of which it forms part) immediately after the ESS deferred taxing point; and
- the first element of the cost base and reduced cost base of the MIP Share is its market value immediately after the ESS deferred taxing point.

33. If the ESS interest was disposed of at the ESS deferred taxing point (including an ESS deferred taxing point under the 30 day rule in subsection 83A-120(3)), any capital gain or loss is disregarded by subsection 130-80(1).

34. Where, in relation to a MIP Share:

- an amount is included in a participant's assessable income under Subdivision 83A-C;
- the participant forfeits the MIP Share under the rules of the Plan; and

- the forfeiture or loss is not the result of a choice by the participant, other than a choice to cease employment,

then the inclusion of the amount in assessable income is taken never to have happened.

35. A participant will not make a capital gain or a capital loss from forfeiture of a MIP Share.

Commissioner of Taxation
15 August 2012

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.

Where right is settled with shares

ESS interests

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

37. Where a participant receives an invitation to participate in the Plan they are deemed to accept that invitation 10 business days from the date of the invitation if no action is taken to the contrary. At this time the participant acquires a right to a MIP Award in respect of MIP Shares, Cash Bonus or Deferred Cash Award, or a combination of those.

38. The right to a MIP Award, is not at that time, a right to acquire a beneficial interest in a share within the meaning of Division 83A.

39. Section 83A-340 provides that where an employee acquires 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.

40. In order for section 83A-340 to apply, the right must be capable of becoming a right to acquire a beneficial interest in a share; and in fact become such a right.

41. Section 83A-340 provides examples of such rights which illustrate that a right to acquire shares with a specified value, or a right to ESS interests or cash at the provider's discretion, are rights capable of becoming rights to acquire a beneficial interest in shares. Therefore, where the right granted to a participant under the Plan is satisfied by the grant of MIP Shares on vesting, section 83A-340 will apply to the right. Division 83A will then apply to the right as if the right had always been a right to acquire a beneficial interest in a share.

42. The right will be an ESS interest acquired under an employee share scheme under section 83A-10 as the right was granted to a participant in relation to their employment as an employee of a company in the Qantas Group.

43. As the right has value and is awarded to a participant for no consideration under the Plan, the right will be acquired at a discount in terms of section 83A-20.

Subdivision 83A-C: real risk of forfeiture

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

45. Section 83A-105 provides that where certain conditions are satisfied, the discount in relation to an ESS interest is not included in a participant's assessable income when they acquire the interest. Instead the assessable income of the participant 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 for a beneficial interest in a right are listed at subsection 83A-105(1).

46. The first condition is that Subdivision 83A-B would, but for section 83A-105, have applied to the interest.

47. The second condition is that when the interest in the company is acquired by the participant, they are employed by that company, or employed by a subsidiary of that company.

48. The third condition is that when the interest in the company is acquired all of the ESS interests available under the employee share scheme relate to ordinary shares.

49. The fourth condition is that:

- the predominant business of the company in which the interests are acquired is not the acquisition, sale or holding of shares, securities or other investments (directly or indirectly); and
- the participant is not employed by both that company and a subsidiary of that company, or a holding company of that company, or a subsidiary of the holding company.

50. The fifth condition is that immediately after the interest is acquired the participant will not hold a beneficial interest in greater than five per cent of the shares, or be in a position to control the casting of greater than five per cent of the votes that might be cast at a general meeting of the company.

51. The sixth and final condition that must be satisfied is that when the interest is acquired there is a real risk, under the conditions of the scheme, that the participant:

- will forfeit or lose the ESS interest (other than by disposing of it, exercising the right or letting the right lapse); or
- if the right is exercised, the employee will forfeit or lose the beneficial interest in the share (other than by disposing of it).

52. Real risk of forfeiture in a scheme may include conditions where retention of the ESS interests is subject to performance hurdles or a minimum term of employment. In cases where an employee share scheme has both employment and performance conditions to be met, and one of these conditions satisfies the 'real risk of forfeiture' test, it is not necessary to consider whether the other condition also satisfies the test.

53. As the MIP Shares a participant acquires in relation to a MIP Award are subject to forfeiture if the participant ceases employment before the end of the Restriction Period, it is accepted that the real risk of forfeiture test is met.

54. As a result, Subdivision 83A-C applies to the right, and Subdivision 83A-B does not apply. The taxation of the right received under the Plan will be deferred until a deferred taxing point occurs.

ESS deferred taxing point

55. Section 83A-120 provides 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 (within the meaning of section 83A-330) in respect of which they acquired the rights;
- seven years after the participant acquired the rights;
- when the right has not been exercised, there is no real risk of forfeiting the right, and the scheme no longer genuinely restricts disposal of the right; and
- 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.

56. However, if the participant disposes of the vested rights to MIP Shares or disposes of the beneficial interest in the MIP Shares within 30 days of the time worked out above, the ESS deferred taxing point will instead be the time of disposal.

57. The term 'exercise' as used in Division 83A is not a defined term, thus it should take its ordinary meaning having regard to its legislative context and the purpose or object of the statute. For the purposes of Division 83A, the concept of 'exercising a right' is not considered to necessarily require an action or activity by the beneficial owner of the right. It is enough that they become the beneficial owner of the share that was the subject of the right, without having to do anything, that is, it happens automatically or is instigated by the employer or another party. Therefore, a participant is taken to have exercised the right to acquire a beneficial interest in a MIP Share on vesting of the MIP Award.

58. Where a participant's award vests, the ESS deferred taxing point in relation to the MIP Award (indeterminate rights) will (subject to the 30 day rule) be the earlier of:

- the first time when the MIP Shares acquired on exercise of those rights are no longer subject to disposal restrictions (including any restrictions imposed by the Qantas Employee Share Trading Policy);
- the time when the participant ceases employment (where they do not forfeit the MIP Shares on ceasing employment); and
- seven years from the date the participant was deemed to have accepted the invitation.

However, where the participant disposes of the beneficial interest in their MIP Shares within 30 days of the earlier of the above times, the ESS deferred taxing point will be the date of disposal.

Amount to be included in assessable income

59. In accordance with section 83A-110 the amount to be included in assessable income in relation to an ESS interest is the market value of the interest at the ESS deferred taxing point reduced by the cost base of the interest.

60. Where an ESS interest is a right that has been exercised at or before the ESS deferred taxing point, the market value of the interest at the ESS deferred taxing point is the market value of the share acquired from exercising the right.

61. Thus the amount included in a participant's assessable income at the ESS deferred taxing point is the market value of the MIP Share at the ESS deferred taxing point less the cost base of the share. As the MIP Award is granted for nil consideration and no amount is paid to exercise the right, the first element of the cost base of the MIP Share is nil.

62. The term 'market value' is not defined for the purposes of Division 83A and therefore the ordinary meaning of market value is used.

63. Where a participant disposes of the MIP Share within 30 days of the time which would otherwise be the ESS deferred taxing point, the assessable income of a participant will be the market value of the MIP Share at the time of disposal less the cost base of the share.

Forfeiture of a MIP Share

64. Section 83A-310 provides that an amount included in assessable income by Division 83A in relation to an ESS interest will be excluded if:

- either:

(i) the individual forfeits the interest; or

(ii) in the case of an ESS interest that is a beneficial interest in a right – the individual forfeits or loses the interest (without having disposed of the interest or exercised the right); and

- the forfeiture or loss is not the result of:

(i) a choice made by the individual (other than a choice by that individual to cease particular employment); or

(ii) a condition of a scheme that has the direct effect of protecting (wholly or partly) the individual against a fall in the market value of the interest.

65. In the context of Division 83A the relevant interest referred to in section 83A-310 includes the beneficial interest in a MIP Share that may be acquired on exercise of the vested MIP Award. The ESS interest, as that term is used in Division 83A, continues in existence until the ESS deferred taxing point occurs.

66. Therefore, section 83A-310 will operate to remove any assessable income of a participant in relation to an ESS interest if the ESS interest (including the MIP Share of which it forms part) is forfeited.

CGT consequences of forfeiture

67. Where a MIP Share is forfeited on or before the ESS deferred taxing point, CGT event C2 happens in accordance with subsection 104-25(1).

68. Where CGT event C2 happens, a capital gain is made if the capital proceeds from the event are more than the asset's cost base. A capital loss occurs if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)).

69. Subsection 130-80(1) will disregard any capital gain or loss resulting from a CGT event if, among other things, the CGT event happens on or before the ESS deferred taxing point for an ESS interest that is subject to Subdivision 83A-C.

70. However, in accordance with subsection 130-80(2), where CGT event C2 happens because a participant forfeits a MIP Share on or before the ESS deferred taxing point, subsection 130-80(1) does not apply to disregard any capital gain or capital loss.

71. Although a participant receives no proceeds from forfeiting a MIP Share, the market value substitution rules in sections 112-20 and 116-30 would, but for the application of subsection 130-80(4) , otherwise apply.

72. Subsection 130-80(4) provides an exception to these market value substitution rules to the extent they relate to the acquisition and subsequent forfeiture (ignoring section 83A-310) of an ESS interest.

73. Therefore, as a result of subsection 130-80(4), a participant will not make a capital gain or a capital loss from forfeiting a MIP Share.

CGT consequences for a MIP Share not forfeited

Time of acquisition of share

74. The time of acquisition of a MIP Share acquired pursuant to a right to which this Ruling applies is immediately after the ESS deferred taxing point of the right, in accordance with section 83A-125.

First element of the cost base and reduced cost base of a MIP Share

75. The first element of the cost base and reduced cost base of a MIP Share acquired by a participant pursuant to a right to which this Ruling applies is the market value of the share immediately after the ESS deferred taxing point of the right, in accordance with section 83A-125, section 112-15, subsection 110-25(2) and subsection 110-55(2).

Disposal within 30 days

76. Where the MIP Share is disposed of within 30 days of the time which would otherwise be the ESS deferred taxing point, any capital gain or capital loss made by a participant from the disposal of the share is disregarded in accordance with subsection 130-80(1).

Disposal after 30 days

77. CGT event A1 happens if there is a change in ownership of a CGT asset from one entity to another. Where the participant disposes of the MIP Shares, the disposal will constitute a CGT event A1 (section 104-10).

78. A capital gain is made if the capital proceeds from the disposal are more than the MIP Share's cost base. A capital loss is made if those capital proceeds are less than the MIP Share's reduced cost base (subsection 104-10(4)).

79. Section 116-20 provides that the capital proceeds from a CGT event is the total of:

- the money received or entitled to be received; and
- the market value of any property received or entitled to be received (worked out as at the time of the event).

80. Consequently, the capital gain, with respect to a MIP Share, will be equal to the money and the market value of any property the participant receives in respect of the disposal less the sum of the market value of the MIP Share at the ESS deferred taxing point and the other elements of the cost base identified in accordance with section 110-25.

Discount capital gain

81. A participant who makes a capital gain from the disposal of a MIP Share that has been held for at least 12 months can treat the gain as a discount capital gain, provided the other requirements of Subdivision 115-A are satisfied (section 115-25).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- acquisition of shares
- capital gains tax
- CGT event
- cost base
- disposal of shares
- employee share ownership
- employee share scheme

Legislative references:

- ITAA 1936 6(1)
- ITAA 1997 Div 83A
- ITAA 1997 83A-10
- ITAA 1997 83A-10(1)
- ITAA 1997 83A-B
- ITAA 1997 83A-20
- ITAA 1997 83A-25(1)
- ITAA 1997 Subdiv 83A-C
- ITAA 1997 83A-105
- ITAA 1997 83A-105(1)
- ITAA 1997 83A-110
- ITAA 1997 83A-120
- ITAA 1997 83A-120(3)
- ITAA 1997 83A-125
- ITAA 1997 83A-310
- ITAA 1997 83A-330
- ITAA 1997 83A-340
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 104-25(1)
- ITAA 1997 104-25(3)
- ITAA 1997 110-25
- ITAA 1997 110-25(2)
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- ITAA 1997 112-15
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- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25
- ITAA 1997 116-20
- ITAA 1997 116-30
- ITAA 1997 130-80(1)
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ATO references
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