

# ***CR 2013/5 - Income tax: Cape PLC conversion of employee share scheme interests from rights to options***

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## Class Ruling

# Income tax: Cape PLC conversion of employee share scheme interests from rights to options

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### **① 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

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

2. The relevant provision dealt with in this Ruling is:

- section 83A-120 of the ITAA 1997;

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

### Class of entities

3. The class of entities to which this Ruling applies is persons who:

- were granted Performance Rights on or after 1 July 2009 under the Cape PLC 2007 Performance Share Plan (Plan);

- at that time of granting the Performance Rights were employees or executive directors of the Cape PLC group of entities (Cape group);
- had a Performance Right that had not vested immediately before the proposed conversion to an Option;
- from the time of granting the Performance Right to the time of the proposed conversion to an Option, are residents of Australia within the meaning of subsection 6(1) of the Income Tax Assessment Act 1936;
- are not 'temporary residents' within the meaning of that expression in section 995-1 of the ITAA 1997; and
- have not had an employee share scheme (ESS) deferred taxing point happen in relation to the Performance Right prior to the proposed conversion to an Option.

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

## Qualifications

4. 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 8 to 22 of this Ruling.
5. 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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7. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 to all entities in 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

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

- Application for Class Ruling dated 13 July 2012 with attachments from BDO Corporate Tax (WA) Pty Ltd (applicant);
- Rules of the Cape PLC 2007 Performance Share Plan; and
- Correspondence from Cape PLC dated 31 October 2012.

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

9. Cape PLC is a registered company in Jersey listed on the London Stock Exchange. It is the parent entity of the Cape group.

### Employee Share Scheme

10. Cape PLC has adopted an employee share scheme in order to attract retain and reward selected employees of the Cape group.

11. The rules of the Scheme are contained in the Cape PLC 2007 Performance Share Plan (Plan).

12. In this Class Ruling, this employee share scheme is referred to as the PSP 2007 Scheme.

13. Under the PSP 2007 Scheme Awards are granted to selected employees and executive directors of the Cape group.

14. The Plan rules provide that an Award can take the form of Performance Rights, Options or Nominal Value Options.

## **The traditional Award**

15. Traditionally, Awards have been granted as Performance Rights.
16. Performance Rights carry a right to acquire ordinary shares in Cape PLC for no consideration and are subject to vesting conditions that include the following:
- satisfaction of specific performance targets; and
  - continual employment for a specified period of at least three years from the grant date.

## **The change in the form of the Award**

17. In accordance with the PSP 2007 Scheme, Cape PLC has decided to convert unvested Performance Rights held by participants into Options.

## **Comparison between the forms of the Award**

18. Both unvested Performance Rights and Options are unlisted rights.
19. Options have the same essential underlying terms and conditions as Performance Rights entitling the participant to acquire shares for nil consideration. In particular, Options are subject to the same vesting conditions including :
- satisfaction of performance standards; and
  - continual employment for a specified period of at least three years from the grant date.
20. Both unvested Performance Rights and Options lapse automatically and are forfeited to the extent that the applicable performance standards are not satisfied, or in the event that the participant voluntarily resigns whilst holding the relevant unvested Award.
21. Performance Rights automatically convert into Shares, whereas Options become exercisable on vesting, with the participant having a further two years to exercise the Options and acquire Shares for nil consideration before the Options expire.
22. There are no disposal restrictions or forfeiture conditions applying to the underlying Shares acquired by a participant on the vesting of Performance Rights or on the exercise of (vested) Options.

## **Ruling**

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23. No ESS deferred taxing point will occur for the purposes of section 83A-120 as a consequence of the conversion of an unvested Performance Right into an unvested Option.

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**Commissioner of Taxation**

23 January 2013

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## Appendix 1 – Explanation

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**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 interest acquired under an employee share scheme**

24. Where an ESS interest is acquired under an employee share scheme at a discount on or after 1 July 2009, the discount in relation to the ESS interest is included in the assessable income of a participant, in accordance with Division 83A.

25. An ESS interest in a company is defined in subsection 83A-10(1) as a beneficial interest in:

- (a) a share in the company; or
- (b) a right to acquire a beneficial interest in a share in the company.

26. An employee share scheme is defined in subsection 83A-10(2) as a scheme under which ESS interests in a company are provided to employees, or associates of employees, of the company, or a subsidiary of the company, in relation to the employee's employment.

27. Thus, where under the Plan a participant is issued Performance Rights they will acquire ESS interests under an employee share scheme.

28. As participants do not pay for their Performance Rights they will be acquired at a discount and, pursuant to subsection 83A-20(1), Subdivision 83A-B will apply to the Performance Rights acquired by participants under the Plan, unless Subdivision 83A-C applies.

### **Performance Rights acquired under the Plan**

#### ***Subdivision 83A-C***

29. Subdivision 83A-C allows for the deferral of tax on the amount assessable in respect of an ESS interest if certain conditions are satisfied. Subdivision 83A-C applies, and Subdivision 83A-B does not apply to an ESS interest which is a right if the following conditions are satisfied:

- (a) subdivision 83A-B would, apart from section 83A-105, apply to the interest; and
- (b) subsections 83A-35(3), (4), (5) and (9) apply to the interest; and

- (c) there is a real risk that a participant will forfeit or lose the interest (other than by disposing of it, exercising the right or letting it lapse) pursuant to subsection 83A-105(3); or there is a real risk that, under the conditions of the scheme, if you exercise the right, you will lose the beneficial interest in the share (other than by disposing of it).

30. In relation to the first condition Subdivision 83A-B would, apart from subsection 83A-105(1), apply to the Performance Right because the right:

- is a beneficial interest in a right to acquire a beneficial interest in a share of Cape PLC; and
- is provided to employees of the Cape group, in relation to their employment, and will be provided for nil consideration (that is, at a discount).

31. In relation to the second condition, subsections 83A-35(3), (4), (5) and (9) apply to each Performance Right granted to a participant because:

- when the Performance Right is acquired, the participant is employed by Cape group (83A-35(3));
- all of the Performance Rights available for acquisition under the Plan relate to ordinary shares in Cape PLC (83A-35(4));
- the predominant business of the Cape group is not the acquisition, sale or holding of shares, securities or other investments, directly or indirectly (83A-35(5)); and
- after the acquisition of the Performance Right, no participant will hold a beneficial interest in more than five per cent of the shares in Cape PLC nor be in a position to cast, or control the casting of, more than five percent of the maximum number of votes that might be cast at a general meeting of Cape PLC (83A-35(9)).

32. In relation to the third condition Subdivision 83A-C will apply to a Performance Right if, under the conditions of the Plan when the Performance Right is granted, there is a real risk that a participant will forfeit or lose the Performance Right (other than by disposing of it, exercising the right or letting it lapse); or there is a real risk that, under the conditions of the scheme, if the participant exercises the right, it will forfeit or lose the beneficial interest in the share (other than by disposing of it).

## Real risk of forfeiture

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

34. It is further explained at paragraph 1.158 of the Explanatory Memorandum 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.

35. In order for the 'real risk of forfeiture' test to be satisfied, in relation to an ESS interest acquired by an employee under an employee share scheme, a reasonable person must consider that there is an actual possibility of forfeiture. Furthermore the risk of forfeiture must be 'real', not nominal, artificial or contrived. There must be more than a mere possibility.

36. 'Real' is defined in *The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne as 'actually existing as a thing or occurring in fact' and 'genuine; rightly so called; not artificial or merely apparent'.

37. When considering whether a condition in a scheme imposes a real risk of forfeiture, the Commissioner will have regard to whether a reasonable person would consider that there is a genuine connection between the forfeiture condition and aligning the interests of the employee and employer.

38. '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.

39. Each Performance Right granted vests subject to meeting satisfactory performance standards and service of not less than three years from the granting of the right.

40. Performance Rights granted to participants under the Plan will vest not earlier than three years after the granting of the right in accordance with the Plan. Performance Rights that have not vested will terminate if the participant ceases to be an employee of Cape group.

41. Therefore, the Commissioner accepts that the Performance Rights granted are at the time of acquisition subject to a real risk of forfeiture or loss for the purposes of paragraphs 83A-105(1)(d) and 83A-105(3)(b).

### **ESS deferred taxing point**

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

43. Section 83A-120 provides that an 'ESS deferred taxing point' for rights to acquire shares occurs at the earlier of the following times:

- 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 (subsection 83A-120(4));
- 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));
- where 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)).

44. However, if the participant disposes of the rights within 30 days of the time which would otherwise be the deferred taxing point, the deferred taxing point will instead be the time of disposal (subsection 83A-120(3)).

### **ESS deferred taxing point – Impact of conversion of Performance Rights to Options**

45. In accordance with the Plan, Cape PLC has decided to convert unvested Performance Rights of participants into Options.

46. Unvested Performance Rights and Options both represent unlisted rights.

47. Options have the same essential underlying terms and conditions (including the same vesting conditions) as Performance rights except that Performance Rights automatically convert into shares for nil consideration, whereas Options become exercisable on vesting, with the participant having a further two years to exercise the Options and acquire Shares for nil consideration before the Options expire.

48. Given that both Performance Rights and Options become exercisable on vesting with no exercise price, this represents a very minor alteration.

49. As the conversion of a Performance Right to an Option does not alter any of the essential underlying terms and conditions (including vesting conditions) of the original unvested Performance Right the conversion is regarded as a continuation of the same ESS interest.

50. The minor change in the terms and conditions, as a consequence of the conversion, does not result in the disposal of an old ESS interest or the acquisition of a new ESS interest. Therefore, there will be no ESS deferred taxing point for the participant, and, as a consequence, no amount to include in assessable income pursuant to section 83A-110.

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

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

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## References

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- Previous draft:*
- ITAA 1997 83A-35(3)
- Not previously issued as a draft
- ITAA 1997 83A-35(4)
  - ITAA 1997 83A-35(5)
  - ITAA 1997 83A-35(9)
- Related Rulings/Determinations:*
- ITAA 1997 Div 83A-C
  - ITAA 1997 83A-105
  - ITAA 1997 83A-105(1)
  - ITAA 1997 83A-105(1)(d)
  - ITAA 1997 83A-105(3)
  - ITAA 1997 83A-105(3)(b)
- TR 2006/10;
- Subject references:*
- employee share schemes and options
    - ITAA 1997 83A-110
    - ITAA 1997 83A-120
    - ITAA 1997 83A-120(3)
    - ITAA 1997 83A-120(4)
    - ITAA 1997 83A-120(5)
    - ITAA 1997 83A-120(6)
    - ITAA 1997 83A-120(7)
- Legislative references:*
- ITAA 1936 6(1)
  - ITAA 1997 Div 83A
  - ITAA 1997 83A-10(1)
  - ITAA 1997 83A-10(2)
  - ITAA 1997 83A-B
  - ITAA 1997 83A-20(1)
  - ITAA 1997 83A- 330
  - ITAA 1997 995-1
  - TAA 1953
  - Copyright Act 1968
- Other references:*
- Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009
  - *The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne
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### ATO references

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