


CR 2014/39 - Income tax: Microsoft Corporation 2001 Stock Plan

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Class Ruling

Income tax: Microsoft Corporation 2001 Stock Plan

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❶ This publication provides you with the following level of protection:

This publication (excluding appendices) 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(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-10 of the ITAA 1997
- section 83A-120 of the ITAA 1997, and
- section 83A-330 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 are employees of Microsoft Pty Ltd (Microsoft Australia) who:

- receive Stock Awards (SAs) under the Microsoft Corporation 2001 Stock Plan – as amended and restated effective as of December 13, 2011
- are residents of Australia within the meaning of that expression in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936), and
- are not temporary residents within the meaning of that expression in subsection 995-1(1).

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 8 to 20 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

7. This Ruling applies from 13 December 2011. 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

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 20 January 2014

- Microsoft Corporation 2001 Stock Plan (as amended and restated effective as of 13 December 2011) and the Microsoft Corporation 2001 Stock Plan Australia Addendum (together referred to as the Plan)
- Microsoft Corporation 2001 Stock Plan, Stock Award and Stock Option Vesting Policies for Leaves of Absence and Part-Time Employment effective 1 July 2013 (the Plan Rules)
- Stock Award Agreement Under the Microsoft Corporation 2001 Stock Plan for Non-US Employees (Award Agreement)
- Offer Document, Microsoft Corporation 2001 Stock Plan, Offer of Stock Awards to Australian Resident Employees, and
- other information provided by the applicant.

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. Microsoft Corporation (Microsoft) is a foreign resident company listed on the NASDAQ in the USA. Microsoft Australia is a wholly owned subsidiary of Microsoft.

The Plan

10. The Plan is an employee incentive plan. The purposes of the Plan are to attract and retain the best available individuals for positions of substantial responsibility, to provide additional incentive to such individuals and to promote the success of Microsoft's business by aligning the financial interest of employees and consultants with long-term shareholder value.

11. Under the Plan, eligible Australian resident employees of Microsoft Australia may be offered a number of SAs at the discretion of the Board of Microsoft (the Board).

12. Upon acceptance of the offer, the eligible employees become Participants in the Plan and the SAs acquired by them will be governed by the Plan Rules and the Award Agreement.

13. Each SA entitles a Participant, after a defined vesting period, to acquire a common share (equivalent to ordinary shares in an Australian corporation) in Microsoft for no consideration.

14. If a Participant ceases employment (for any reason except death or total and permanent disability) during a vesting period, any unvested SAs will be forfeited. The Board retains the discretion to waive forfeiture of any unvested SAs when a Participant ceases employment in these circumstances, however this discretion will not be exercised on a routine basis.

15. Where a Participant ceases employment due to death or total and permanent disability, any unvested SAs will become immediately vested.

16. Immediately after the acquisition of their SAs, no Participant will hold a beneficial interest in more than 5% of the shares in Microsoft and no Participant will be in a position to cast or control the casting of more than 5% of the votes that may be cast at a general meeting of Microsoft.

17. SAs are non-transferrable except upon the death of a Participant.

Vesting of SAs

18. SAs will vest continuously on a semi-annual basis over a five year period from the time of acquisition under an offer. As such, a Participant must remain an employee of Microsoft Australia for a six month vesting period in order for 10% of their acquired SAs to vest.

19. After each six month vesting period, 10% of the total SAs acquired by a Participant under an offer will be converted into common shares in Microsoft and distributed to the Participant for no consideration within 90 days of the vesting date.

20. Upon vesting, some Participants may be subject to disposal restrictions on their common shares under the Microsoft Corporation General Insider Trading Policy and will only be allowed to dispose of their common shares during specified trading windows.

Ruling

21. The SAs acquired by Participants under the Plan are ESS interests for the purposes of subsection 83A-10(1).

22. The SAs acquired by Participants under the Plan are at real risk of forfeiture and Subdivision 83A-C applies in relation to the SAs.

23. No amount will be included in a Participant's assessable income in relation to the SAs until the ESS deferred taxing point occurs.

24. The ESS deferred taxing point determined in accordance with section 83A-120 will be the earliest of the following times:

- when the employee ceases employment within the meaning of section 83A-330 with Microsoft Australia and the forfeiture clause is waived, or
- when the SAs vest in accordance with the SA Agreement and no disposal restriction applies, or

- immediately after the end of the period where a disposal restriction applies to the common shares acquired upon vesting of the SAs. This will be at the start of the first trading window subsequent to the vesting of the SAs.

25. Where a Participant disposes of the common shares within 30 days of the time which would otherwise be the deferred taxing point, the ESS deferred taxing point will instead be the time of disposal.

Commissioner of Taxation

16 April 2014

Appendix 1 – Explanation

① *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 acquired under an employee share scheme

26. Division 83A provides for the taxation of ESS interests (shares, stapled securities and rights to acquire shares and stapled securities) acquired under an employee share scheme at a discount.

27. For the purposes of Division 83A an ESS interest in a company is defined under subsection 83A-10(1) as 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.

28. An SA issued under the Plan is an ESS interest as it is right to acquire a beneficial interest in a common share in Microsoft.

29. 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.

30. The Plan is an employee share scheme for the purpose of subsection 83A-10(2) as the SAs, which are ESS interests, are provided to the participants in relation to their employment.

Subdivision 83A-B

31. Under subsection 83A-20(1), Subdivision 83A-B will apply to an ESS interest if the interest is acquired under an employee share scheme at a discount. As Participants do not pay for their SAs they will be acquired at a discount. Accordingly, Subdivision 83A-B will apply to the SAs acquired by Participants under the Plan, unless Subdivision 83A-C applies.

32. 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.

Subdivision 83A-C

33. Subdivision 83A-C provides that where certain conditions are satisfied, the discount in relation to a beneficial interest in a right to acquire a beneficial interest in a share is not included in an employee's assessable income when they acquire the interest. Instead, under section 83A-110 the assessable income of the employee will include at a later time, the market value of the interest at the ESS deferred taxing point reduced by the cost base of the interest. The conditions to be satisfied for the interest to be eligible for an ESS deferred taxing point are listed at subsection 83A-105(1).

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

35. The second condition is that the interest be an interest in the company that employed the employee, or the holding company of that company.

36. The third condition is that all interests available under the employee share scheme must relate to ordinary shares.

37. 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), or if it is
- the employee is not employed by that company and also a subsidiary of that company or a holding company of that company, or a subsidiary of the holding company.

38. The fifth condition is that immediately after the interest is acquired the employee will not hold a beneficial interest in greater than 5% of the shares, or be in a position to control the casting of greater than 5% of the votes that might be cast at a general meeting of the company.

39. The Commissioner accepts for the purposes of Subdivision 83A-C, that in relation to SAs acquired by a Participant under the Plan, the first five conditions have been satisfied.

40. The sixth and final condition that must be satisfied is that there must be a real risk, under the scheme rules, 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 Participant will forfeit or lose the beneficial interest in the share (other than by disposing of it).

Real risk of forfeiture

41. 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.

42. '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.

43. 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.

44. The Plan has been designed to motivate, reward and retain employees in the Microsoft group. The SAs granted will vest semi-annually over a five year period. There is an incentive for Participants to remain employed with Microsoft Australia as they will be provided regularly with common shares in Microsoft.

45. A condition imposing a minimum employment period from the grant date will only meet 'the real risk of forfeiture test' if the risk is genuine, having regard to the circumstances and the deferral period under the scheme.

46. Although the vesting period of the SAs is the same as the relatively short term of employment period, the unvested SAs will still be subject to forfeiture if the Participant ceases employment before the vesting date.

47. Furthermore, even where a disposal restriction applies to the common shares acquired upon vesting, a deferred taxing point will still occur on the occasion of the first trading window subsequent to the vesting time. Consequently, the Plan operates such that the deferral period for the SAs is not considered to be excessive when compared to the term of employment.

48. Although Microsoft has a general discretion to waive conditions such as forfeiture and vesting conditions in the event of a Participant ceasing employment this discretion will not prevent the SAs from being held at real risk of forfeiture as the discretion will not be exercised on a routine basis.

49. In terms of determining whether there is an alignment of the interests of the employer and the employee, it is relevant to consider that only a small portion (10%) of the total SAs will vest at the six monthly vesting period and the Participant needs to remain an employee for the entire five year vesting period to obtain the benefit of the total offer of SAs.

50. The Commissioner therefore accepts that the risk of forfeiture is genuine having regard to the circumstances and the deferral period under the Plan. The Plan provides more than a 'mere' or 'rare' possibility of forfeiture and as such does not prevent the Plan from having a purpose of retaining employees and aligning their interests with the interests of the company.

51. Participants will have a real risk of forfeiting or losing their SAs acquired under the scheme and the SAs will satisfy the condition in subsection 83A-105(3).

ESS deferred taxing point

52. 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.

53. The ESS deferred taxing point for a right is worked out under section 83A-120. It will be at the earliest of the following times:

- the time when there is no longer a real risk of forfeiting or losing the right (other than by disposing of it, exercising it or letting it lapse), or
- there is no real risk that if you exercise the right you will forfeit or lose the share (other than by disposing of it) and there is also no genuine restriction on disposal of the share, or
- the time when the Participant ceases the employment in respect of which they acquired the right, within the meaning of section 83A-330 and the Board decides to waive the forfeiture clause.

54. Therefore, unless the Participant ceases employment earlier, the ESS deferred taxing point for the SAs will be when the SAs vest in accordance with the SA Agreement unless disposal conditions apply.

55. For a Participant whose common shares, acquired on vesting of the SAs, are subject to a disposal restriction under the Microsoft Corporation General Insider Trading Policy, the deferred taxing point will be immediately after the end of the period where the disposal restriction applies to the common shares. This will be at the start of the first trading window subsequent to the vesting of the SAs.

56. If the Participant disposes of the common shares acquired on vesting of the SAs within 30 days after the first occurrence of one of the above times, the ESS deferred taxing point will instead be the time of the disposal.

Appendix 2 – Detailed contents list

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

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References

<i>Previous draft:</i>	- ITAA 1997 83A-10
Not previously issued as a draft	- ITAA 1997 83A-10(1)
	- ITAA 1997 83A-10(2)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 83A-20(1)
TR 2006/10	- ITAA 1997 83A-25(1)
	- ITAA 1997 83A-105
<i>Subject references:</i>	- ITAA 1997 83A-105(1)
- employee share schemes	- ITAA 1997 83A-105(3)
- ESS deferred taxing point	- ITAA 1997 83A-110
	- ITAA 1997 83A-120
	- ITAA 1997 83A-330
<i>Legislative references:</i>	- ITAA 1997 83A-340
- ITAA 1936 6(1)	- ITAA 1997 995-1(1)
- ITAA 1997 Div 83A	- TAA 1953
- ITAA 1997 Subdiv 83A-B	- Copyright Act 1968
- ITAA 1997 Subdiv 83A-C	

ATO references

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