

# ***CR 2019/48 - Hivint Pty Limited - Employee Option Plan***



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## Class Ruling

### Hivint Pty Limited – Employee Option Plan

#### **❶ Relying on this Ruling**

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or pay any penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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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 provisions identified in this Ruling apply to the defined class of entities, who take part in the scheme to which this Ruling relates.
2. Full details of this Employee Option Plan are set out in paragraphs 9 to 39 of this Ruling.

#### **Who this Ruling applies to**

3. This Ruling applies to employees, including those who are treated as employees for the purposes of Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>1</sup> by the application of section 83A-325 to Hivint Pty Ltd (Hivint) and its subsidiaries, collectively 'the Hivint Group', who:

- acquired options under the Hivint Pty Ltd Employee Option Plan on one or more of the following dates: 29 July 2016 (Tranche 1); 1 September 2017 (Tranche 2); or 1 October 2018 (Tranche 3)
- were employed by the Hivint Group at all times from the date of grant of options until the completion of the Share Sale Agreement

<sup>1</sup> All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

- held their options at all times from the date(s) of the grant of the options until the completion of the Share Sale Agreement
- were Australian tax residents within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) at the time they acquired the options and remained Australian tax residents until completion of the Share Sale Agreement
- were not temporary residents within the meaning of subsection 995-1(1)
- upon acquiring the options did not hold (for the purposes of Division 83A) a beneficial interest in more than 10% of the shares, or rights to acquire shares, in Hivint, and
- were not in a position to cast, or control the casting of, more than 10% of the maximum number of votes that might be cast at a general meeting of Hivint.

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

### **When this Ruling applies**

5. This Ruling applies from 1 July 2016 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public Rulings*).

## **Ruling**

### **Ruling 1 – Minimum holding period**

6. For the purposes of subsection 83A-45(4), the Commissioner will exercise his discretion under paragraph 83A-45(5)(a) to allow the minimum holding period to be reduced for all the vested options in Tranches 1 and 2 that qualify, if any, for concessional treatment under section 83A-33. The Commissioner will allow the minimum holding period to be the period starting when the options were acquired on 29 July 2016 (Tranche 1) and 1 September 2017 (Tranche 2) and ending at the time the Share Sale Agreement was completed on 28 December 2018.

7. We note that the Commissioner would not exercise his discretion to allow the minimum holding period to be reduced for options in Tranche 3.

### **Ruling 2 – Not assessable income**

8. The Commissioner confirms that optionholders with unvested options (including those who were issued options in Tranche 3) are not required to include any amounts in their assessable income under Division 83A in any income year from 1 July 2016 to 30 June 2019.

## **Scheme**

9. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

10. Hivint is an Australian proprietary company that has operated a business since 2 February 2015. Prior to 28 December 2018, it had five shareholders.

11. In July 2016, Hivint established the Hivint Pty Ltd Employee Option Plan (Plan). The Plan is governed by the Employee Option Plan Rules (Plan Rules).

12. The Plan provides for options to subscribe for fully paid ordinary shares in the Hivint Group to be granted to Eligible Persons for no consideration (options). Each option entitles an Eligible Person<sup>2</sup> (or their nominee) to acquire one ordinary share in the Hivint Group for a pre-determined fixed price (Exercise Price).

13. The Hivint Group has issued three tranches of options under the Plan to certain employees of the Hivint Group (participant). The dates of these three tranches were 29 July 2016 (Tranche 1), 1 September 2017 (Tranche 2) and 1 October 2018 (Tranche 3).

14. The Hivint Group has issued a total of 112,000 options under the Plan, of which 70,122 were unvested and 41,878 had vested.

## **Plan Rules**

15. The Plan Rules detail the default vesting conditions which specify that:

- the Board may, in its discretion, determine or vary any vesting conditions or other vesting events in respect of any options
- 25% of the options vest 12 months after the issue date and the remaining 75% of options vest on a quarterly basis over the next 3 years
- options will only vest while the Eligible Person remains employed with or provides consulting services to a Hivint Group (including acting as the director), and
- options will cease to vest for the duration of any unpaid leave of absence.

16. The Plan deals with the disposal of a legal or beneficial interest in an option, subject to the disposal restriction, as follows:

- a transfer by an optionholder of any of its options to a nominee or trustee for that person, and any such nominee or trustee may transfer options to any other nominee or trustee or to the beneficiary, provided that no beneficial interest in the options passes as a result of the transfer
- a transfer of options by an optionholder who is a natural person to the trustee or trustees of a family trust set up for the benefit of that person's family provided that a person acquiring options pursuant to Rule 4(b)(2) is not entitled to transfer any options except for a transfer to the person from whom the transferee acquired the options
- in the event of the death of an optionholder, a transfer or transmission of the deceased optionholder's options to the deceased optionholder's estate

<sup>2</sup> 'Eligible Person' is defined in the Plan Rules as any employee, contractor or director of the Hivint Group selected by the Board to participate in the Employee Option Plan.

- a transfer by an optionholder of any of its options where such transfer has been consented to in writing by the Board, or
  - a sale or transfer by an optionholder of any of its options where such sale or transfer is otherwise permitted or required by these rules.
17. The Plan Rules impose the following disposal restrictions on the options:
- no disposal before an Exit Event (that is, a Listing, business sale or Share Sale<sup>3</sup>), and
  - an overriding restriction on disposal whereby a legal or beneficial interest in an option, or a share acquired as a result of exercising an option, may not be disposed of until the earlier of three years after the issue of the option or such early time as the Commissioner allows in accordance with subsection 83A-45(5), and where the optionholder becomes a Leaver.<sup>4</sup>
18. The Plan Rules also state that on or prior to an Exit Event, the Board may, in its absolute discretion, buy back or cancel some or all of the options (whether vested or not) in exchange for their Fair Market Value.<sup>5</sup> In case of a Reconstruction as part of the Exit Event, the Board may, in its absolute discretion arrange for some or all of the options to be acquired by the New Holding Entity in exchange for their Fair Market Value on the date of completion of the Reconstruction.

### **Tranches**

19. On 29 July 2016, the first tranche of options were issued by the Hivint Group under the Plan to approximately 18 employees of the Hivint Group (Tranche 1). The Exercise Price for options issued in Tranche 1 was \$3.00 per option.
20. On 1 September 2017, a second tranche of options was issued by the Hivint Group under the Plan to approximately 15 employees of the Hivint Group (Tranche 2). The Exercise Price for options issued in Tranche 2 was \$4.00 per option.
21. On 1 October 2018, a third tranche of options was issued by the Hivint Group under the Plan to approximately 20 employees of the Hivint Group (Tranche 3). The Exercise Price for options issued in Tranche 3 was \$5.05 per option.

### **Share Sale**

22. In February 2017, Optus Cyber Security Pty Ltd (purchaser) approached the co-founders of Hivint Group in relation to the Share Sale.

<sup>3</sup> Rule 4(c) deals with restriction on disposal of the options. It states that unless otherwise consented to by the Board in writing and notwithstanding any other provision in the Plan or an offer, a legal or a beneficial interest in an option may not be disposed of until after: (1) where a Listing occurs, the earlier of the date that is one hundred and eighty (180) days following the Listing; and the expiration of any underwriter imposed lock-up in connection with the Listing; and (2) in the case of any other Exit Event, the occurrence of that Exit Event.

<sup>4</sup> Rule 4(d) deals with the overriding restriction on disposal of options in the first 3 years. It states that unless an optionholder disposes of an option or an option share under an arrangement which meets the requirements in section 83A-130, a legal or a beneficial interest in an option or an option share may not be disposed of until the earlier of: (1) 3 years after the issue of the option or such earlier time in accordance with section 83A-45(5), and (2) where the optionholder becomes a Leaver (as defined in Rule 3(a)).

<sup>5</sup> Fair Market Value is defined in the Plan Rules as 'as of any date, the Fair Market Value of an option, as determined by the Board in good faith on such basis as it deems appropriate and applied consistently with respect to all options'.

23. The purchaser proposed to acquire 100% of the equity share capital of the Hivint Group, or 100% of the assets of the Hivint Group and its subsidiaries, or any other transaction to be agreed by the parties.

24. Following a brief discussion, it was concluded that there was no 'common ground' and a sale was not possible.

25. In September 2017, the purchaser contacted the Hivint Group to re-visit the discussion.

26. In October 2017, the Hivint Group met various stakeholders of the purchaser and provided some data to the purchaser.

27. From October 2017, the parties negotiated the Share Sale on an ad hoc basis until the purchaser put forward initial figures as a potential offer in April 2018. At this time, the Hivint Group engaged a merger and acquisition advisor and proceeded to pursue a non-binding indicative offer.

28. On 7 June 2018, the purchaser submitted a preliminary non-binding Letter of Intent to the Hivint Group in relation to the Share Sale. The Letter of Intent outlines the general terms and condition of the proposed transaction and to provide a basis for further discussion and negotiation.

29. On 8 June 2018, the Hivint Group agreed the terms and conditions as set out in the Letter of Intent.

30. Hivint Group and the purchaser first began conducting due diligence on each other in June 2018, which essentially concluded in August 2018.

31. On 5 October 2018, a Board of Directors meeting was held between two of the co-founders of the Hivint Group, in which they reviewed the Share Sale Agreement with lawyers and advisers.

32. On 10 October 2018, the Hivint Group and its shareholders executed an agreement with the purchaser for the Share Sale and purchase of all of the issued capital in the Hivint Group.

33. On 11 October 2018, a co-founder of the Hivint Group notified the employees of the Share Sale via email.

34. On 4 December 2018, the Deed of Amendment was executed to amend the Share Sale Agreement dated 10 October 2018.

35. On 10 December 2018, a Board of Directors meeting was held to confirm that the Share Sale Agreement was amended by a Deed of Amendment dated 4 December 2018. It was noted that pursuant to the Plan Rules, the Board may, in its absolute discretion in an Exit Event, buyback the options which have been issued to the optionholders (whether vested or not) in exchange for their Fair Market Value.

36. On 28 December 2018, the Hivint Group completed the Share Sale transaction, in which the documents lodged with the Australian Securities and Investments Commission (ASIC) show that, amongst other things, the Hivint Group made changes to the register of members (in which all shareholdings were transferred to the purchaser).

37. During the meeting, the Board of Directors resolved that:

- for the purposes of the Employee Option Plan, upon 'Completion', all of the vested options will be bought back and cancelled
- in exchange for the buy back and cancellation of the vested options, the Hivint Group will pay the Completion Option Payment to the optionholders of vested options on completion and procure a buyer group member to grant

each optionholder of vested options the right to receive the 'Additional Payments' in the amounts and on the conditions set out in Annexure A of the Agreement

- for the purposes of the Employee Option Plan, the payment of the Completion Option Payment and the right to receive the Additional Payments in the amounts and on the conditions set out in the Agreement is Fair Market Value, and
- that, subject to the agreement of each holder of unvested options (such agreement to be in a form approved by the buyer) each of the unvested options will lapse upon Completion.

38. Essentially, as part of the Share Sale transaction, the Hivint Group bought back all vested options issued in the Tranches 1 and 2 under the Plan and that any unvested options (issued in any tranches) were forfeited by optionholders for no consideration.

39. The consideration for the Buy Back of the vested options on issue under the Plan was:

- payment of an amount on Completion of the share sale by the Hivint Group to the optionholders ('Completion Option Payment'), and
- grant of the right to optionholders to receive Additional Payments.

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**Commissioner of Taxation**

14 August 2019

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## Appendix 1 – Explanation

**❶** *This Explanation 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.*

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### Explanation 1 – Minimum holding period

40. The Tranche 1 and 2 options acquired under the Plan by the participants were Employee Share Scheme (ESS) interests subject to Division 83A.

41. Section 83A-25 operates to include the discount the participant receives in relation to their options in their assessable income for the year in which they acquired the options.

42. Section 83A-33 operates to reduce the amount included in the participants' assessable income under section 83A-25 if certain conditions are met. Amongst the conditions that must be met are those contained in section 83A-45.

43. Subsection 83A-45(4) states that:

It applies to an \*ESS interest you acquire under an \*employee share scheme if, at all times during the interest's \*minimum holding period, the scheme is operated so that every acquirer of an ESS interest (the scheme interest) under the scheme is not permitted to dispose of:

- (a) the scheme interest; or
- (b) a beneficial interest in a \*share acquired as a result of the scheme interest;

during the scheme interest's minimum holding period.

44. Subsection 83A-130(3) states that subsection 83A-45(4) is taken to apply in the case of a takeover or restructure.

45. An ESS interest's minimum holding period is defined in subsection 83A-45(5) as:

... the period starting when the interest is acquired under the employee share scheme and ending at the earlier of:

- (a) 3 years later, or such earlier time as the Commissioner allows if the Commissioner is satisfied that:
  - (i) the operators of the scheme intended for subsection (4) to apply to the interest during the 3 years after that acquisition of the interest; and
  - (ii) at the earlier time that the Commissioner allows all membership interests in the relevant Hivint Group were disposed of under a particular scheme; and
- (b) when the acquirer of the interest ceases being employed by the relevant employer.

46. Under the Plan, the participants were unable to dispose of their options, or any shares from the exercise of the options, unless three years had passed from the time of acquisition, the participant's employment ceased, or the disposal was under an arrangement which met the requirements of section 83A-130.



47. Under the Plan Rules, it specifically prevent a participant from disposing of his/her interest prior to the end of its minimum holding period, and there is no evidence indicating that such disposal has taken place.

48. The Commissioner is satisfied that Hivint Group had intended, at the time that the Tranche 1 and 2 options were acquired by the participants, that the participants would be unable to dispose of the options during the three years following their acquisition. The Commissioner is satisfied that at the time the Tranche 1 and 2 options were acquired, the Board intended that these options would be held through the minimum holding period.

49. As part of the Share Sale Agreement, all membership interests in the Hivint Group were disposed of to the purchaser.

50. Thus, for the Tranche 1 and 2 vested options that qualify for concessional treatment under section 83A-33, if any, the Commissioner will allow the minimum holding period to be the period starting from the time the Tranche 1 and 2 options were acquired to the time the Share Sale was completed on 28 December 2018.

51. We note that the Commissioner would not exercise his discretion under subsection 83A-45(5) to reduce the minimum holding period for the Tranche 3 options issued on 1 October 2018.

52. At the time the Tranche 3 options were issued and acquired by the participants in October 2018, the Share Sale was already underway. Having regard to the circumstances surrounding the Share Sale, it is reasonable to conclude that the operator of the Hivint Pty Ltd Employee Option was aware (and/or should have been aware) those options would be disposed of within the three years following their acquisition by participants as those options would not be held because of the possible Share Sale.

### **Explanation 2 – Not assessable income**

53. For the third tranche of options issued on 1 October 2018, subsection 83A-310(1)<sup>6</sup> provides that Division 83A (apart from Subdivision 83A-E) is taken never to have applied in relation to an ESS interest acquired by an individual under an ESS if:

- a) disregarding this section, an amount is included in the individual's assessable income under this Division in relation to the interest; and
- b) either:
  - (i) the individual forfeits the interest; or
  - (ii) in the case of an ESS interest that it 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
- c) 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 the scheme that has the direct effect of protecting (wholly or partly) the individual against a fall in the market value of the interest.

<sup>6</sup> The amendments to section 83A-310 in *Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015* are applicable to grants made on or after 1 July 2015.

54. The Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No.2) Bill 2009 explains that:

- 1.325 The new law provides for a refund of tax paid in relation to ESS interests in certain circumstances where those interests are forfeited after the employee has been taxed on the discount.
- 1.326 The refund is only available where the employee had no choice but to forfeit the ESS interest (except when that choice was to cease employment), and where the conditions of the scheme were not constructed to protect the employee from market risk.
- 1.327 Under such circumstances, the forfeited ESS interest is treated as never having been acquired, and the taxpayer can claim a refund of income tax by requesting that the Commissioner amend their income tax assessment to remove income previously included in their assessable income.
- 1.328 There is no time limit on amending an assessment to exclude an amount from a taxpayer's assessable income for a share interest which is forfeited, or for a right which was lost without being exercised. ***[Schedule 1, item 19, item 30 in the table in subsection 170(10AA) of the ITAA 1936]***
- 1.329 As the refund provisions are not intended to protect the employee from downside market risk, a refund will not be available where the share interest is forfeited due to a choice of the employee (except when that choice was to cease employment). Such a choice may include a choice not to exercise or dispose of an ESS interest, or some other choice of the employee that results in the forfeiture of the ESS interest.
- 1.330 Specifically, the new law is taken never to have applied in relation to an ESS interest (resulting in a refund of any previously paid income tax) where:
  - an amount of employee share scheme discount has been, or would be, included in the employee's assessable income;
  - the employee has either forfeited the ESS interest or, in the case of a right, the employee has lost the right without having disposed of or exercised it; and
  - the forfeiture or loss is not the result of a choice made by the individual (except when that choice was to cease employment), and nor is it the result of a condition of the scheme that has the direct effect of wholly or partly protecting the employee from a fall in the market value of the ESS interest.

***[Schedule 1, item 1, section 83A-310]***

- 1.331 Whether or not forfeiture is as a result of a choice of an employee is something to be assessed on a case-by-case basis.
- 1.332 A choice to leave employment does not result in ineligibility for a refund. This provision recognises that in most cases a decision to leave employment will not primarily be based on the employee share scheme tax consequences of that decision, and that a refund of tax paid over the forfeited ESS interests is appropriate in such cases.
- 1.333 A situation in which an employee ceases employment primarily to avoid the employee share scheme rules, such to obtain a refund, only to recommence employment with the same employer shortly after, will likely be subject to the general anti-avoidance rules.
- 1.334 In situations where a refund is not available under the refund provisions, the taxpayer may be able to claim a capital loss under the CGT provisions.

55. The Hivint Group has requested that the Commissioner confirms that under section 83A-45(5) optionholders with unvested options (including those who were issued

options in Tranche 3) are not required to include any amounts in their assessable income under Division 83A in any income year from 1 July 2016 to 30 June 2019.

56. In the circumstances of the Hivint Group optionholders, provided that the unvested options were forfeited without consideration, section 83A-310 would apply to treat the forfeited ESS interests as never having been acquired, and the participants can claim a refund of income tax by seeking an amendment to their income tax assessment to remove the income previously included in their assessable income. There is no time limit on amending an assessment to exclude an amount from a taxpayer's assessable income for an unvested ESS option which is lost without being exercised: subsection 170(10AA) of ITAA 1936.

**References***Previous draft:*

Not previously issued as a draft

- ITAA 1997 83A-45(4)
- ITAA 1997 83A-45(5)
- ITAA 1997 83A-45(5)(a)
- ITAA 1997 83A-130
- ITAA 1997 83A-130(3)
- ITAA 1997 83A-310
- ITAA 1997 83A-310(1)
- ITAA 1997 83A-325
- ITAA 1997 995-1(1)

*Related Rulings/Determinations:*

TR 2006/10

*Legislative references:*

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 170(10AA)
- ITAA 1997
- ITAA 1997 Div 83A
- ITAA 1997 Subdiv 83A-E
- ITAA 1997 83A-25
- ITAA 1997 83A-33
- ITAA 1997 83A-45

- TAA 1953
- Tax and Superannuation Laws Amendment (Employee Share Schemes) Act 2015

*Other references:*

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

## ATO references

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