


IT 2553 - Income tax: assessability of a lump sum payment received by an employee for the surrender of valuable rights granted by an employer

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TAXATION RULING NO. IT 2553

INCOME TAX: ASSESSABILITY OF A LUMP SUM PAYMENT
RECEIVED BY AN EMPLOYEE FOR THE SURRENDER OF VALUABLE
RIGHTS GRANTED BY AN EMPLOYER.

F.O.I. EMBARGO: May be released.

REF

N.O. REF: 88/1110-5

DATE OF EFFECT: Immediate

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1011486	ASSESSABLE INCOME	25(1) 26(e) 26AAC

PREAMBLE

This ruling is issued in consequence of a decision of the Full Federal Court of Australia reported as FC of T v McArdle 89 ATC 4051; 19 ATR 1901 in which Davies, Gummow and Lee JJ. unanimously dismissed the Commissioner's appeal from a decision of the Federal Court of Australia (Fisher J.) reported as McArdle v FC of T 88 ATC 4222; 19 ATR 985.

2. The issue before the Federal Court concerned the assessability of a lump sum payment received by an employee from his employer in return for the surrender of valuable rights, in the nature of options, previously granted by the employer.

FACTS

3. The taxpayer was the managing director of Delhi Australia, a subsidiary of the U.S. incorporated Delhi International Oil Corporation. From December 1975 the taxpayer was granted various options to acquire shares in Delhi Australia. In addition the taxpayer was granted rights under a Limited Stock Appreciation Rights Agreement (LSARA). Basically that agreement provided that, in the event of a takeover, Delhi Australia would pay the taxpayer an amount calculated by reference to the excess of the offer price per share over the "Exercise Price" per share. The exercise price per share referred to the value of the shares on the day the various options were granted. The LSARA was drafted to circumvent the US Securities Exchange Act which required officers of companies to "disgorge" profits made on the trading of the company's shares at or about the time of the takeover.

4. In the 1981 tax year Delhi Australia was the subject of a takeover and the taxpayer became entitled to exercise his rights under the LSARA. However, advice received by Delhi Australia from its U.S. solicitors suggested that rather than the taxpayer exercising any of his rights, he should surrender, cancel, discharge or waive whatever rights he possessed in consideration

for a lump sum payment by Delhi Australia. Accordingly, on 11 November 1981 the taxpayer received a lump sum of \$1,100,000.

5. It was sought to assess the amount to the taxpayer under either paragraph 26(e) or sub-section 25(1) of the Income Tax Assessment Act ("ITAA"). However, section 26AAC of the ITAA was conceded to have no application. That concession was regarded as proper since a surrender or abandonment of rights could not constitute a "disposal of that right to a person" within sub-section 26AAC(8). The right went out of existence without coming to be "acquired" by another person.

DECISION

6. The Full Federal Court rejected the argument that paragraph 26(e) applied to include the \$1.1m as assessable income in the year in which the rights were surrendered. The Court agreed with Fisher J. in the first instance that what had occurred under the surrender agreement was not the granting of a valuable benefit under sub-section 26(e), but the exploitation of rights received from the employer in previous years.

7. Delhi International, the court said, did not grant to the taxpayer a valuable benefit in respect of, or for, or in relation directly or indirectly to services he had rendered to the Delhi group. What had really happened was that the taxpayer had provided consideration in the form of the options and rights which he held. They had a value equal to or greater than the consideration received from Delhi International. Therefore the taxpayer had not received a valuable benefit.

8. The Full Federal Court also agreed with Fisher J. that the \$1.1m could not be income under sub-section 25(1) because it was a capital receipt being received as consideration for the surrender of valuable rights.

RULING

9. The decision of the Full Federal Court is accepted. It should be noted however, that in similar factual situations, where the valuable rights are granted to the employee on or after 20 September 1985, a capital gains tax liability may arise where consideration is given for the disposal of the rights. For capital gains tax purposes disposal includes, where the asset is a chose in action or any other right or an interest or right in or over property, the cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry, or abandonment, at law or in equity, of the asset (paragraph 160M(3) (b) ITAA).

COMMISSIONER OF TAXATION
17 August 1989

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