



TD 2009/3 - Income tax: employee share schemes: for the purpose of subsection 139CD(6) of the Income Tax Assessment Act 1936, does a taxpayer become the holder of a beneficial interest in shares merely by acquiring a contractual right to obtain shares in a company (the particular, individual shares not being ascertained at the time)?

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Taxation Determination

Income tax: employee share schemes: for the purpose of subsection 139CD(6) of the *Income Tax Assessment Act 1936*, does a taxpayer become the holder of a beneficial interest in shares merely by acquiring a contractual right to obtain shares in a company (the particular, individual shares not being ascertained at the time)?

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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.

Ruling

1. No.

Date of effect

2. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination 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 Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

11 March 2009

Appendix 1 – Explanation

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.*

Legislative references

3. All legislative references are to the *Income Tax Assessment Act 1936*.

Background

4. Employee share schemes commonly allow for the grant of share options to employees. Typically these are call options. A call option over a share gives the holder the right, but not the obligation, to obtain a share in a specified company at a predetermined date or during a predetermined period (the maturity date or exercise period) and at a predetermined amount (the exercise price).

5. The concept of an option is not legally precise. There is more than one legal means to achieve what may loosely be described as the grant of an option to obtain a share in a company.

6. Normally, under employee share schemes the terms of the option are governed by a contract between the parties conferring the relevant right on the employee, and there is no express trust or other more elaborate arrangement. This Determination is concerned only with call options of this nature; that is, where the employee's express rights in relation to any relevant share are purely contractual.

7. The tax consequences of acquiring a right to obtain a share in a company 'under an employee share scheme'¹ are governed by Division 13A of Part III (Division 13A).

8. If the right is a 'qualifying right', the employee taxpayer may choose one of two alternative concessions under Division 13A. The first alternative is that the taxable value of the right (which is called the 'discount' given in relation to the right) may be included in the taxpayer's assessable income in the income year in which the 'cessation time'² occurs rather than the year in which the option is acquired.³ The second alternative is available only if the 'exemption conditions'⁴ are satisfied for the right and the taxpayer makes an election under section 139E covering the right. In that case, the total amount of the discounts given in relation to such rights is included in the taxpayer's assessable income for the year of acquisition but only to the extent that their total is greater than \$1,000.⁵

9. For a right to be a qualifying right, the conditions in section 139CD must be satisfied.

10. One of those conditions is that immediately after acquiring the right, the taxpayer must not hold a legal or beneficial interest in more than 5% of the shares in the company to which the right relates: subsection 139CD(6). By acquiring an option to obtain a share, does an employee acquire a beneficial interest in a share for the purposes of this condition?

¹ See section 139C. An option is acquired 'under an employee share scheme' if a taxpayer acquires it at a discount and in respect of, or for or in relation directly or indirectly to, any employment of, or any services provided by, the taxpayer or of an associate of the taxpayer.

² See section 139CB.

³ See subsection 139B(3).

⁴ See section 139CE.

⁵ See section 139BA.

Analysis

11. The expression 'hold a legal or beneficial interest' in a share is not defined for the purposes of subsection 139CD(6). The Commissioner understands the expression to cover any kind of proprietary right over a share, whether recognised by law or equity.

12. Some grants of options are to be regarded as arising under a contract for the sale of the underlying property that is conditional on the grantee later exercising the option. Some other grants of options are to be regarded as the grantor making a contractually binding promise to keep open an offer to sell the underlying property should the grantee later elect (that is, by exercising the option) to accept that offer, thus creating at that time a contract for the sale of the property.⁶

13. For the purposes of applying subsection 139CD(6) to a simple arrangement of the kind covered by this Determination, it does not matter which of these situations exists. Even if the grant of a particular option to acquire a share is correctly regarded as immediately creating a conditional contract for the sale of a share, merely entering into a contract for the sale of unascertained personal property does not create in the grantee any proprietary right, whether legal or equitable, in that property.

14. The grantee of the option in such a case is not, before exercising the option, the legal owner of any particular share. Nor would any principle of equity recognise the grantee as holding any proprietary interest over any particular share immediately after the option is granted. There is no authority to suggest that a constructive trust arises in this case.

15. Accordingly, on acquiring a merely contractual right to obtain a share in a company under an employee share scheme, the particular share being not yet ascertained, a taxpayer does not become the holder of a legal or beneficial interest in a share for the purposes of subsection 139CD(6).

More elaborate arrangements

16. The above analysis is concerned with the simplest kinds of option arrangements found in typical employee share schemes. The position might be different for some arrangements that are more elaborate. For example, if immediately on the grant of options particular shares are held on an express trust for the benefit of a particular employee; or if the contractual arrangements relate to particular, ascertained shares and the remedy of specific performance might be available to the grantee for a breach of the contract (as in the case of a contract for the sale of particular existing shares in a private company: see *Neville v. Wilson* [1996] 3 All ER 171). Such arrangements are beyond the scope of this Determination.

⁶ See *Laybutt v. Amoco Australia Pty Ltd* (1974) 132 CLR 57; 4 ALR 482.

References

Previous draft:

TD 2008/D18

Related Rulings/Determinations:

TR 2006/10

Subject references:

- acquisition of shares
- employee share schemes & options
- qualifying rights

Legislative references:

- ITAA 1936
- ITAA 1936 Pt III Div 13A

- ITAA 1936 139B(3)
- ITAA 1936 139BA
- ITAA 1936 139C
- ITAA 1936 139CB
- ITAA 1936 139CD
- ITAA 1936 139CD(6)
- ITAA 1936 139CE
- ITAA 1936 139E

Case references:

- Laybutt v. Amoco Australia Pty Ltd (1974)
132 CLR 57, 4 ALR 482
- Neville v. Wilson [1996] 3 All ER 171

ATO references

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