

# ***CR 2007/48 - Income tax: UBS AG Key employee lending incentive plan***

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2006*



## Class Ruling

### Income tax: UBS AG Key employee lending incentive plan

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#### **ⓘ 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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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

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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:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 6-10 of the ITAA 1997;
- section 8-1 of the ITAA 1997;
- section 104-10 of the ITAA 1997;
- section 104-25 of the ITAA 1997;
- Subdivision 115-C of the ITAA 1997;
- section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- section 12-300 of Schedule 1 to the *Taxation Administration Act 1953* (TAA).

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

## **Class of entities**

3. The class of entities to which this Ruling applies is employees of UBS AG, Australia branch (UBS) and UBS Global Asset Management (Australia) Ltd (GAMA) who:

- participate in the proposed Key employee lending incentive plan (the Plan); and
- are Australian residents within the meaning of subsection 6(1) of the ITAA 1936, who are not temporary residents within the meaning of subsection 995-1(1) of the ITAA 1997.

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 scheme 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 13 to 27 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.

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## Date of effect

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8. This Ruling applies from the income tax year ending 30 June 2007.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the TAA).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

## Scheme

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13. The following description of the scheme is based on information provided by the applicant.

14. The scheme that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of the documents incorporated into the description of the schemes are:

- application for Class Ruling dated 15 December 2006;
- Key Employee Lending Incentive Plan Participation Election Form (the election form);
- facility agreement between UBS, GAMA, UBS Wealth Management Australia Nominees Pty Ltd (the Nominee) and the participant;

- Product Disclosure Statements for UBS investment products provided under cover of letter dated 19 December 2006; and
- letter from UBS to participants dated 12 February 2007.

15. UBS and GAMA have established the Plan as part of their remuneration strategy for employees.

16. UBS AG, which is a non-resident within the meaning of subsection 6(1) of the ITAA 1936, carries on business in Australia through a permanent establishment (UBS).

17. The Plan will be operated in accordance with the terms of a facility agreement between UBS (as lender), GAMA, the Nominee and individual participants.

18. Key Australian based employees will be invited to participate in the Plan, which provides for an employee:

- to defer the receipt (to a later time) of up to 100% of cash incentive awards (bonuses) to which they may become entitled;
- to receive a loan from UBS of up to 200% of the deferred bonus; and
- to be paid the deferred bonus, net of any amount required to be withheld by law, at the later time (including having the deferred bonus applied to repay the loan from UBS).

## **Loan from UBS**

19. A loan from UBS to a participant will be:

- a full recourse loan;
- secured and repayable in accordance with the terms of the facility agreement; and
- interest free, unless:
  - a participant ceases employment with UBS in Australia before the third anniversary of the date on which the bonus would have been payable. In which case the participant may be required to pay interest on the loan from the time the loan is drawn down until the date of cessation of employment or the date the loan is repaid, if that is earlier; and/or

- a participant fails to repay the loan in accordance with the terms of the facility agreement by the due date. In which case UBS may impose interest on the outstanding amount for a 30 day period commencing from the date the loan is due to be repaid, and must impose interest on the outstanding amount if the loan is outstanding after 30 days.
20. Under the Plan, the loan funds advanced to a participant:
- are required to be paid to GAMA and applied, on the day the funds are advanced, to acquire units in authorised investment funds managed by UBS Asset Management in Australia; and
  - the acquired units will be mortgaged to UBS as security for the loan.
21. The facility agreement provides that legal title to a participant's investments will be held by the Nominee, or where UBS so directs, by the participant.
22. The applicant has advised that where the Nominee holds the legal title to a participant's investments:
- they hold the investments as bare trustee; and
  - the participant will be absolutely entitled to their investments as against the Nominee.
23. The facility agreement provides for the loan to a participant to be repaid at any time subject to the loan being repaid by the earlier of:
- three years and six months after the date on which the bonus would generally have been payable (the Bonus Payment Date); or
  - the time when the participant ceases employment (in accordance with the terms of the facility agreement).

#### **Authorised investments**

24. The applicant has advised that:
- the authorised investment funds are expected to continue to produce income which will be assessable income of the participants;
  - where a participant holds legal title to the units, a participant will be presently entitled to the income of the funds in proportion to their unit holdings;
  - all net income of these funds in a financial year, will be distributed to unit holders;

- where a participant's units are held by the Nominee, the participant will be presently entitled to income received by the Nominee in respect of these units; and
- the Nominee will distribute all net income received in respect of these units in a financial year, to the participant.

## **Disposal restrictions**

25. Units held by participants (or the Nominee on their behalf) under the Plan will be subject to disposal restrictions in accordance with the terms of the facility agreement.

26. The disposal restrictions will cease to apply once the loan has been fully repaid (except where the loan is repaid early, and the facility agreement provides for the disposal restrictions to continue until a later time).

27. Whilst disposal restrictions are in place, the facility agreement provides for units to be disposed of or redeemed, provided the proceeds are immediately used to acquire units in other authorised investment funds managed by UBS Asset Management in Australia.

## **Ruling**

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### **Deferral of bonus**

28. Where under the Plan, a participant defers the receipt of a portion of their bonus, the deferred portion will not be included in their assessable income under section 6-5 until the income year in which the deferred portion is paid or applied on their behalf.

### **Loan from UBS**

29. The loan amount advanced by UBS to a participant under the Plan will not be included in the participant's assessable income under section 6-5 or 6-10.

### **Investment fund income**

30. Where under the Plan, a participant has legal title to units in an investment fund and the participant is not under a legal disability, they will be assessable on their share of net income of the investment fund, under section 97 of the ITAA 1936.

31. Where under the Plan, the Nominee holds units in an investment fund for the benefit of a participant, the income of the investment fund to which the Nominee as a beneficiary is presently entitled, will form part of the net income of the trust of which the Nominee is trustee.

32. Where the participant is not under a legal disability, they will be assessable on the share of net income of this trust, pursuant to section 97 of the ITAA 1936.

33. To the extent that the participant's share of the net income of the investment funds, or their share of the net income of the trust of which the Nominee is trustee, includes capital gains, the capital gains will be assessable to the participant in accordance with Subdivision 115-C.

#### **Disposal or redemption of an investment unit**

34. Where units acquired by a participant under the Plan are disposed of or redeemed (whether the units are legally held by the participant or the Nominee), the participant will make a capital gain or capital loss:

- where units are disposed of, pursuant to section 104-10; or
- where units are redeemed, pursuant to section 104-25.

#### **Deduction for interest**

35. Where under the Plan a participant is required to pay interest to UBS, the participant will be entitled to a deduction for the interest, pursuant to section 8-1.

#### **Withholding obligations**

36. Where under the Plan a participant pays interest to UBS, the participant will not be required to withhold an amount from that interest, pursuant to section 12-300 of Schedule 1 to the TAA.

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**Commissioner of Taxation**

30 May 2007

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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.*

### Ordinary and statutory income

37. Section 6-5 provides that the assessable income of a person, who is an Australian resident, shall include the ordinary income derived by the person from all sources during a year of income, and a person is taken (in accordance with general principles) to derive an amount as ordinary income when it is received (refer to Taxation Determination TD 93/242), or when the amount is applied or dealt with on behalf of the person or as they direct (pursuant to subsection 6-5(4)).

38. Section 6-10 similarly provides that the assessable income of a person, who is an Australian resident, shall include amounts included as statutory income, and such amounts if not received will become statutory income of the person when they are applied or dealt with on behalf of the person or as they direct (pursuant to subsection 6-10(3)).

### Deferral of bonus

39. Thus, a person will not derive ordinary income (or statutory income) from the provision of personal services until such an amount of income has been received by them or has been applied or dealt with in any way on their behalf or as they direct.

40. Where under the Plan a participant defers the receipt of a portion of their bonus:

- the participant will not receive the bonus on the Bonus Payment date; and
- the loan from UBS received by the participant will not constitute an amount of income that has been applied or dealt with in any way on their behalf or as they direct.

41. Thus, the participant will not be assessable on the deferred portion of their bonus in the income year in which the Bonus Payment date falls.

### Payment of deferred bonus

42. Under the Plan, the deferred bonus will either be applied (net of PAYG) to reduce the UBS loan balance (if the loan is not paid on the day the loan is due to be repaid) or paid to the participant (net of PAYG).

43. Thus, the deferred bonus will be derived by a participant and included in the participant's assessable income in the income year it is paid to the participant or applied to reduce their loan balance.

### **Loan from UBS**

44. Loan funds received under a loan by a borrower are not income according to ordinary concepts, nor are they included as statutory income of the borrower. Thus where a loan amount is advanced to a participant under the Plan, the amount advanced will not be included in the participant's assessable income under section 6-5 or section 6-10.

45. The provision of the loan to a participant under the Plan constitutes the provision of a loan fringe benefit for the purposes of the *Fringe Benefit Tax Assessment Act 1986*.

46. To the extent that the provision of this loan constitutes income derived by the participant, the income is not assessable income or exempt income of the participant, pursuant to subsection 23L(1) of the ITAA 1936.

47. Therefore, the loan funds received by a participant and any income derived by way of the provision of the UBS loan, will not be assessable income of the participant.

### **Investment fund income**

48. Where a person (who is not a temporary resident within the meaning of subsection 995-1(1)) is a beneficiary of a trust estate and they are:

- not under a legal disability; and
- are presently entitled to a share of the income of the trust estate,

their assessable income, pursuant to section 97 of the ITAA 1936, includes so much of that share of net income as is attributable to a period when they were a resident (within the meaning of subsection 6(1) of the ITAA 1936).

49. Thus, where a participant (being a resident and not being a temporary resident, who is presently entitled to the income of investment funds acquired in their name under the Plan) is not under a legal disability, they will be assessable on their share of the net income of the investment funds.

50. To the extent that the net income of the investment funds includes capital gains, the capital gains will be assessable to the participant in accordance with Subdivision 115-C.

51. Where the Nominee holds units in an investment fund on behalf of a participant, the proportionate share of the income of the fund to which the Nominee is presently entitled (in its capacity as a beneficiary) will form part of the net income of a trust (of which the Nominee is trustee).

52. Thus, where a participant (being a resident and not being a temporary resident, who is presently entitled to the income of this trust) is not under a legal disability, they will be assessable on their share of the net income of this trust, pursuant to section 97 of the ITAA 1936.

53. To the extent the net income of this trust includes capital gains, the capital gains will be assessable to the participant in accordance with Subdivision 115-C.

### **Disposal or redemption of an investment unit**

54. A unit in a unit trust is an intangible asset and a capital gains tax (CGT) asset within the meaning of section 108-5. Thus, where a participant or the Nominee acquires a unit in an investment fund under the Plan they will acquire an intangible asset that is a CGT asset.

55. Section 106-50 provides that where a beneficiary is absolutely entitled to a CGT asset held by a trustee, Part 3-1 and Part 3-3 will apply to an act done by the trustee in relation to the CGT asset as if the beneficiary had done it.

56. Thus, as the Commissioner accepts the statement by the applicant that where a participant's units are held by the Nominee, the participant will be absolutely entitled to the units as against the Nominee, Part 3-1 and Part 3-3 will apply to acts done by the Nominee in relation to the units as if the participant had done them.

57. Where a participant (or the Nominee) disposes of a unit in an investment fund acquired under the Plan, CGT event A1 will happen as there will be a change of ownership of the unit from the participant to another person (subsection 104-10(1)). The participant will make a capital gain if the capital proceeds from the disposal are more than the cost base of the unit or conversely a capital loss if the capital proceeds from the disposal are less than the reduced cost base of the unit (subsection 104-10(4)).

58. Where a participant's (or the Nominee's) ownership of a unit in an investment fund acquired under the Plan, ends by the unit being redeemed, CGT event C2 will happen (subsection 104-25(1)). The participant will make a capital gain if the capital proceeds from the redemption are more than the cost base of the unit or conversely a capital loss if the capital proceeds from the redemption are less than the reduced cost base of the unit.

59. For either CGT event A1 or CGT event C2:

- the capital proceeds from that event will be the money (or the market value of any property) a participant (or the Nominee) receives or is entitled to receive in respect of the event happening (subsection 116-20(1)); and
- the first element of the cost base of the unit will be the loan funds used to purchase the unit (subsection 110-25(2)).

60. Any capital gain made by a participant in respect of the CGT event will be a discount capital gain within the meaning of section 115-5 where the event happens at least 12 months after the participant (or Nominee) acquires the unit.

### **Deduction for interest**

61. The Commissioner generally accepts the principle that interest incurred to acquire units in a trust that produces, or may in the future produce assessable income, will be deductible to the entity incurring the interest (refer to Taxation Ruling TR 95/33).

62. As the applicant has advised that the authorised investment funds are expected to continue to produce income which will be assessable income of the participants, the Commissioner accepts that any interest incurred by a participant while they are holding units under the Plan will be deductible under section 8-1.

63. Where under the Plan a participant incurs interest after they have disposed of their units because:

- the proceeds from the sale of the units (together with the deferred bonus) are insufficient to repay the loan; or
- a participant ceases employment before the third anniversary of the Bonus Payment Date, and they have already sold their units and repaid the loan, and UBS imposes interest in respect of the period for which the loan was outstanding,

the Commissioner accepts that the nexus between such interest and the income producing activity of holding the units will continue such that the interest will be deductible under section 8-1 in accordance with the Commissioner's views in Taxation Ruling TR 2004/4.

### **Withholding obligations**

64. Section 12-245 of Schedule 1 to the TAA provides that in certain circumstances, an entity must withhold an amount from interest it pays to a non-resident entity. However, section 12-300 of Schedule 1 to the TAA provides that where no withholding tax is payable in respect of the interest, there is no requirement to withhold.

65. The term withholding tax, as used in the TAA, means liability to tax under section 128B of the ITAA 1936.

66. Section 128B(5) of the ITAA 1936 provides that where a non-resident entity derives interest income to which section 128B of the ITAA 1936 applies, the non-resident entity has a liability to pay income tax on that interest income.

67. However, subparagraph 128B(3)(h)(ii) of the ITAA 1936 provides that where the interest income is derived by the non-resident entity from carrying on business in Australia through a permanent establishment of the non-resident, subsection 128B(5) of the ITAA 1936 will not apply, unless the interest income is derived by a limited partner in a venture capital limited partnership (VCLP) or an Australian venture capital fund of funds (AFOF) as a partner.

68. As any interest income that UBS AG derives under the Plan will be from carrying on business in Australia through its permanent establishment in Australia (UBS), and as UBS AG will not derive the interest income as a limited partner in a VCLP or AFOF, subsection 128B(5) of the ITAA 1936 will not apply.

69. Thus, as no withholding tax will be payable on the interest, participants will not be required to withhold an amount from that interest, pursuant to section 12-300 of Schedule 1 to the TAA.

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

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TD 93/242; TR 95/33; TR 2004/4

*Subject references:*

- assessable income
- deferred income
- deferred salary payment
- employment contract
- interest deduction
- loan fringe benefit

*Legislative references:*

- ITAA 1936 6(1)
  - ITAA 1936 23L(1)
  - ITAA 1936 97
  - ITAA 1936 128B
  - ITAA 1936 128B(5)
  - ITAA 1936 128B(3)(h)(ii)
  - ITAA 1997 6-5
  - ITAA 1997 6-5(4)
  - ITAA 1997 6-10
  - ITAA 1997 6-10(3)
  - ITAA 1997 8-1
  - ITAA 1997 Pt 3-1
  - ITAA 1997 104-10
  - ITAA 1997 104-10(1)
  - ITAA 1997 104-10(4)
  - ITAA 1997 104-25
  - ITAA 1997 104-25(1)
  - ITAA 1997 106-50
  - ITAA 1997 108-5
  - ITAA 1997 110-25(2)
  - ITAA 1997 Subdiv 115-C
  - ITAA 1997 115-5
  - ITAA 1997 116-20(1)
  - ITAA 1997 Pt 3-3
  - ITAA 1997 995-1(1)
  - TAA 1953 Sch 1 357-75(1)
  - TAA 1953 Sch 1 12-245
  - TAA 1953 Sch 1 12-300
  - FBTAA 1986
  - Copyright Act 1968
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ATO references

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