


CR 2003/92 - Income tax: Thales SA 'World Leverage 2002' Employee Share Offer

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Class Ruling

Income tax: Thales SA ‘World Leverage 2002’ Employee Share Offer

Contents	Para
What this Class Ruling is about	1
Date of effect	8
Arrangement	9
Ruling	27
Explanation	38
Detailed contents list	54

Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings** TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- Section 23L of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Division 13A of the ITAA 1936;
- Section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 104-25 of the ITAA 1997;
- Section 110-25 of the ITAA 1997;
- Subsection 112-20(1) of the ITAA 1997;
- Division 110 of the ITAA 1997;
- Division 115 of the ITAA 1997;
- Subsection 116-20(1) of the ITAA 1997;
- Section 43 of the *Fringe Benefit Tax Assessment Act 1986* (FBTAA 1986); and
- Section 136 of the FBTAA 1986.

Class of persons

3. The class of persons to which this Ruling applies consists of the Australian residents employed by Thales SA's Australian employer companies. These include Thales ATM Pty Ltd, Thales Solutions Australia Pty Ltd, Thales Geosolutions (Australasia) Ltd, Thales Training & Simulation Pty Ltd and Thales Underwater Systems Pty, who will participate in the offer under the arrangement described below in paragraphs 9 to 26. This ruling also applies to the class of persons consisting of the Australian residents employed by ADI Ltd and its Australian subsidiaries who will participate in the offer under the arrangement below in paragraph 9 to 26. For convenience, these companies are collectively referred to below as the Thales SA group.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described below at paragraphs 9 to 26 in this Ruling.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies to arrangements entered into during the income year ending 30 June 2003. This Ruling continues to apply, in respect of the tax law(s) ruled upon, even following 30 June 2003, for arrangements entered during the income year ended 30 June 2003. This is subject to there being no material change in the arrangement or in the class of persons involved in the arrangement. However, this 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Arrangement

9. The arrangement that is the subject of the Ruling is described below. It is entered into when the subscriptions referred to in paragraphs 12 to 14 below are made by employees. This description is based on the documents listed below. These documents, or the 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 documents incorporated into this description of arrangement are:

- The application for Class Ruling dated 28 February 2003;
- Regulations of the 'Actionnariat Salarie Thales' A multi-compartment *Fonds Commun de Placement D'Enterprise (FCPE)*;
- Information Notice for the multi-compartment *fonds commun de placement d'entreprise*;
- Swap Agreement between the FCPE and Deutsche Bank (draft);
- Underwriting Guarantee Agreement (draft);
- Securities Sale Agreement (draft); and
- Draft Group Savings Plan (with amendments).

Note: certain information received has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

Description of the arrangement

10. 'World Leverage 2002' is an arrangement under which Australian resident employees of the Thales SA group may invest in securities concerning a portfolio of Thales SA shares. It is referred to as the 'Leverage Plan' to distinguish it from the 'World Classic 2002' offer, known as the 'Classic Plan'.

11. Under the Leverage Plan the share portfolio is held through a multi-compartment *Fonds Commun de Placement d'Enterprise* (FCPE). A FCPE is a collective investment vehicle without legal personality commonly used in France to facilitate employee share offers. There are six compartments of the FCPE; 'World Leverage 2002' is one.

12. The FCPE manager subscribes for ordinary shares in the capital of Thales SA pursuant to a capital increase reserved to company employees on a worldwide basis by Thales SA. The shares are held by the FCPE custodian in the name of the FCPE.

13. The 'subscription price' payable on behalf of the FCPE is at a discount of 20% to the 'reference price' – the average of the opening market price of the Thales SA shares over the 20 trading days preceding the date the price is set by the board of directors of Thales SA or its president as applicable (i.e. 2 July 2002).

14. The minimum investment under the Leverage Plan has been fixed at 120 euro. The maximum amount that may be invested is 25% of the employee's 2002 estimated gross annual compensation, however, the maximum number of shares which an employee may purchase in the Leverage Plan may be subject to additional limitations. The amount invested may be paid by account deduction or by bank debit.

15. In consideration for their investment employees are allotted units in the FCPE. When a unit is issued, one unit is equivalent to the value of one Thales SA share. However, from that time the value of a unit is the 'Net Asset Value' as defined under the FCPE By-laws. Accordingly the units held are an entitlement to a fraction of the net assets held under the name of 'World Leverage 2002'.

16. Units may be redeemed by a unit holder for the 'Guaranteed Net Asset Value' at the maturity date of 2 April 2007 or earlier in the event that a condition for early redemption is satisfied.

17. At the maturity date unit holders may redeem their entitlements for Thales SA shares. In the case of early redemption, e.g. the unit holder ceases employment with the Thales SA group, the unit holder's entitlements, based on the Guaranteed Net Asset Value at the relevant time, are satisfied by Thales SA shares. If a unit holder fails to redeem their units at the maturity date their entitlements will be transferred to the Classic Plan.

18. Employees in subscribing for units in the FCPE pay 10% of the Subscription Price, i.e. 10% of the amount that the FCPE manager must pay for the allotment of Thales SA shares under the Plan.

19. Deutsche Bank AG pays to the FCPE manager the remaining 90% of the Subscription Price, pursuant to a 'Swap Transaction' agreement. For example:

Reference Price	\$100
Discount allowed by Thales SA	\$(20)
Subscription Price payable by FCPE on behalf of employee to	
Thales SA	\$ 80
Employee contribution (i.e.10% of \$80)	\$ (8)
Deutsche Bank AG payment (90% of \$80)	\$ 72

20. Accordingly, if on these assumed facts, an employee contributes \$80 the FCPE manager will subscribe for and be allotted 10 Thales SA shares. The balance of the subscription price of \$720 is met by a Swap Transaction payment from Deutsche Bank AG. The employee will then be allocated one unit in the FCPE, for every Thales SA share allotted.

21. Under the Swap Transaction agreement, Deutsche Bank AG also provides a guarantee (Guaranteed Net Asset Value) to the effect that, upon redemption of the unit holder's units, the unit holder will receive:

- (a) Shares representing the amount of the unit holder's initial investment; and
- (b) Shares representing the specified percentage of any increase in the price above the Reference Price of the Thales SA shares which were subscribed for using the unit holder's funds and the funds supplied by Deutsche Bank.

Based on the data given in paragraph 21, the unit holder would be entitled to Thales SA shares to the value of \$80 regardless of whether Deutsche Bank AG's contribution of \$720 can be fully recovered by

the bank having regard to the value of Thales SA shares at the date of redemption.

22. Under the Leverage Plan, unit holders renounce their right to receive any sums equivalent to dividends paid on the Thales SA shares held by the FCPE custodian on behalf of the Fund. As dividends are received the FCPE manager is required to pay them to Deutsche Bank AG under the terms of the Swap Transaction agreement.

23. In addition, when the Swap Transaction agreement comes to an end, which is when the unit holder redeems their units or the unit holder's entitlements are transferred to the Classic Plan, the bank is entitled to payment of:

- (a) The amount initially provided by the bank i.e. 90% of the Subscription Price (\$720 based on the example at paragraph 21 above):
- (b) The difference between the subscription price and the reference price (\$200 based on the example above being \$20 discount on each of 10 shares that the FCPE manager subscribes for with the bank's contribution); and
- (c) A specified proportion (e.g. 30%) of any excess of the value of the Leverage Plan shares over the Adjusted Reference Price. (If the market value of Thales SA shares at the redemption time is \$200, the amount would be \$300 being \$30 multiplied by 10).

24. The FCPE manager may meet this commitment under the Swap Transaction agreement by transfer of Thales SA shares to Deutsche Bank AG.

25. The value of the obligations under the Swap Transaction agreement is taken into account in determining the value of net assets of the FCPE. Accordingly, where the market value of Thales SA shares rises above the Reference Price, it may be expected that the value of the obligation under the Swap Agreement will also increase. However, the Guaranteed Net Asset Value should also increase because unit holders are effectively entitled to a specified percentage (e.g. 70%) of the increase in value of shares acquired with the Bank's contribution. Continuing with the above example, at redemption time, the position simplified would be –

Value of FCPE portfolio

10 Thales SA shares @ \$200	\$2000
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Value of Swap Agreement obligation

Contribution	\$720
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Discount	\$200
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Share of increase in value	\$300
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	\$1220
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Guaranteed Net Asset Value = Unit Value	\$ 780
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26. In the circumstances described above, at redemption the FCPE manager would transfer three Thales SA shares valued at \$600 and pay the balance of \$180 in cash.

Ruling

27. When units in the Fund are issued to an Australian resident employee, they constitute a fringe benefit as defined in subsection 136(1) of the FBTAA 1986.

28. Fringe benefits are exempt from income tax in the hands of the employees, under section 23L of the ITAA 1936.

29. Dividends received by the FCPE manager in relation to Thales SA shares held in the name of the FCPE are not assessable to the Australian resident unit holders.

30. If an Australian resident unit holder redeems units or the unit holders entitlements are transferred to the Classic Plan, a CGT event C2 occurs pursuant to section 104-25 of the ITAA 1997. A capital gain results if the capital proceeds exceed the cost base of the units. A capital loss occurs if the capital proceeds are less than the unit holder's reduced cost base.

31. The capital proceeds of a redemption (CGT event C2) consist of any cash received and the market value of any shares acquired in consideration for the redemption (subsection 116-20(1) applies).

32. In the case of an Australian resident unit holder's entitlements being transferred to the Classic Plan, the capital proceeds consist of the market value of the units issued in the Classic Plan at the date of the transfer (subsection 116-20(1) applies).

33. The cost base or reduced cost base of the units redeemed or cancelled on transfer of entitlements to the Classic Plan consists of the amount invested by the unit holder i.e. their contribution to the Subscription Price. (section 110-25 applies).

34. If an Australian resident unit holder makes a capital gain on redemption of units or the transfer of entitlements to the Classic Plan and units were acquired 12 months or more prior to the CGT event C2 happening, the gain is a discount capital gain pursuant to Division 115 of the ITAA 1997.

35. If an Australian resident unit holder, having redeemed units in consideration for Thales SA shares, disposes of the shares, a CGT event A1 happens (refer section 104-10). The capital gain or capital loss with respect to the disposal is calculated on the basis of the first element of cost base or reduced cost base of the shares being their market value at the date of acquisition. If a capital gain is made, it will be a discount capital gain pursuant to Division 115 if the acquisition of the shares occurred 12 months or more prior to the disposal.

36. In the case of an Australian resident unit holder's entitlements being transferred to the Classic Plan, the cost base or reduced cost base of the units issued in the Classic Plan on transfer of entitlement to the Classic Plan consists of the value of the Leverage Plan units given up (or transferred).

37. If an Australian resident unit holder makes a capital gain on redemption of the units in the Classic Plan that were issued on account of transferred Leveraged Plan entitlements, and the entitlements were transferred 12 months or more prior to the CGT event C2 happening, the gain is a discount capital gain pursuant to Division 115 of the ITAA 1997.

Explanation

Exemption of the benefit from acquisition of units at a discount

38. The provision of units in the FCPE to Australian resident employees is a fringe benefit for the purposes of the FBTAA 1986. The provision of units are a 'fringe benefit' as defined in subsection 136(1) as the units are a benefit that are provided to an employee by the employee's employer and are provided in respect of their employment with the Thales SA group.

39. The benefit provided is not excluded from the fringe benefits tax regime by paragraph (ha) of the definition of 'fringe benefit' in subsection 136(1); it is not 'a benefit constituted by the acquisition by a person of a share or right under an employee share scheme (within the meaning of Division 13A of Part III of the *Income Tax Assessment Act 1936*)'. In this regard the unit holder's interest under the Fund regulations (a chose in action) is not identical with the inherent or underlying interest that the unit holder may have in shares that are part of the net assets. The issue is discussed in greater depth in CR 2003/53 at paragraphs 47 to 56 inclusive.

40. The fringe benefit is classified as an external property fringe benefit, the taxable value of which falls for determination under section 43 of the FBTA 1986.

41. In accordance with section 23L of the ITAA 1936 Australian resident employees acquiring units in the Fund are exempt from tax on the benefit obtained.

Taxation of dividends

42. Dividend income received with respect to Thales SA shares held in the name of the FCPE will not be assessable income of Australian resident unit holders as they are not entitled to that income. Under the terms of the offer and in accordance with the Swap Transaction agreement, the Deutsche Bank AG is entitled to the dividends.

Capital Gains Tax

43. The general capital gains tax rules under Part 3-1 of the ITAA 1997 apply to CGT events in relation to the interests in net assets of the FCPE represented by units and shares acquired via redemption of units. The units are not units in a unit trust and Taxation Determination TD 2000/32 does not apply.

44. Section 104-25 provides that CGT event C2 happens if your ownership of an intangible CGT asset ends by it being redeemed or cancelled. Accordingly when an Australian resident unit holder redeems units in the FCPE there will be a CGT event.

45. If the redemption is satisfied fully or partly by the transfer of Thales SA shares, the capital proceeds with respect to CGT event C2 will include the market value of the shares at the date of the redemption in addition to any money received (refer subsection 116-20(1)).

46. Under Division 110 the cost base or reduced cost base of the units includes the subscription price paid by the unit holder.

47. If a unit holder redeems FCPE units for Thales SA shares and subsequently sells the shares, a CGT event A1 occurs pursuant to section 104-10 with respect to the shares. The first element of the cost base or reduced cost base of the shares will be the market value of the shares at the date they were acquired (subsection 112-20(1) applies).

48. For the purposes of Division 115 (discount capital gains) the time of acquisition of units will be the date that the units were subscribed for by the unit holder.

49. Thales SA shares obtained by redeeming units in the FCPE are acquired when they are transferred to the unit holder on or immediately after the redemption time for the purposes of Division 115 (discount capital gains).

50. If an Australian resident unit holder does not redeem their units on the maturity date of 2 April 2007, the unit holder's entitlements are transferred from the Leverage Plan to the Classic Plan. This involves a transfer made on the basis of the Net Asset Value for units under the two Funds at that time. The unit holder will then receive an allocation of units in the Classic Plan in satisfaction of rights under the Leverage Plan. This is a CGT event C2 under section 104-25.

51. The capital proceeds will include the market value of the units received in the Classic Plan at the date of the transfer of the Australian resident unit holder's entitlements (refer subsection 116-20(1)). The cost base or reduced cost base in relation to this CGT event will be as indicated in paragraph 47.

52. If an Australian resident unit holder redeems their units in the Classic Plan that were issued on account of transferred Leverage Plan entitlements, the cost base or reduced cost base of the units issued in the Classic Plan consists of the value of the Leverage Plan units given up (or transferred).

53. If an Australian resident unit holder makes a capital gain on redemption of the units in the Classic Plan and the entitlements were transferred from the Leverage Plan 12 months or more prior to the CGT event C2 happening, the gain is a discount capital gain pursuant to Division 115 of the ITAA 1997.

Detailed contents list

54. Below is a detailed contents list for this Class Ruling:

	Paragraph
What this Class Ruling is about	1
Tax law(s)	2
Class of persons	3
Qualifications	4
Date of effect	8
Arrangement	9
Description of the arrangement	10
Ruling	27

Explanation	38
Exemption of the benefit from acquisition of units at a discount	38
Taxation of dividends	42
Capital Gains Tax	43
Detailed contents list	54

Commissioner of Taxation

22 October 2003

Previous draft:

Not previously released in draft form

- reduced cost base

- reinvested income

*Related Rulings/Determinations:*CR 2001/1; CR 2003/53; TR 92/1;
TR 97/16; TR 92/20; TD 2000/32*Legislative references:*

- ITAA 1936 23L
- ITAA 1936 Div 13A
- ITAA 1936 Div 13A Part III
- ITAA 1997 Part 3-1
- ITAA 1997 104-10
- ITAA 1997 104-25
- ITAA 1997 110-25
- ITAA 1997 112-20(1)
- ITAA 1997 Div 110
- ITAA 1997 Div 115
- ITAA 1997 116-20(1)
- FBTAA 1986 43
- FBTAA 1986 136
- FBTAA 1986 136(1)
- FBTAA 1986 136(1)(ha)
- Copyright Act 1968
- TAA 1953 Part IVAAA

Subject references:

- Acquisition of share or right
- capital gains tax
- CGT event A1
- CGT event C2
- cost base
- chose-in-action
- discount capital gains
- dividends
- employee savings plan
- employee share schemes
- external property fringe benefit
- Fonds Commun De Placement D'Enterprise
- fringe benefit
- fringe benefits tax

ATO references

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