


CR 2012/42 - Income tax: demerger of Phillips 66 by ConocoPhillips Company - employee share schemes

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Class Ruling

Income tax: demerger of Phillips 66 by ConocoPhillips Company – employee share schemes

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① 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, 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.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions 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:

- former Division 13A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-75 of the ITAA 1997;
- section 112-20 of the ITAA 1997;
- section 115-215 of the ITAA 1997;
- subsection 130-85(4) of the ITAA 1997;
- section 130-90 of the ITAA 1997; and

- Division 83A of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997).

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 all Australian resident employees of ConocoPhillips Company (COPCo) Group and its subsidiaries who were granted:

- rights (RSUs) under the COPCo Restricted Stock Unit Plan (the US Plan) before, on and after 1 July 2009; and/or
- an interest in shares under a salary sacrifice arrangement with the ConocoPhillips Australian Employee Share Plan (the Australian Plan) before, on and after 1 July 2009; and

who at the time of the demerger described in paragraphs 11 to 17:

- were holding those RSUs or interests in shares; and
- had not yet had a cessation time or an ESS deferred taxing point happen in relation to those RSUs or interests in shares.

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

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. 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 10 to 23 of this Ruling.

7. 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

9. This Ruling applies from 1 July 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 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).

Scheme

10. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them, form part of and are to be read with the description:

- the request for a class ruling dated 31 January 2012;
- additional information provided in response to the ATO's request for further information dated 6 March 2012;
- excerpts from ConocoPhillips' application to the Internal Revenue Service dated 28 October 2011;
- Trust Deed and Rules of the ConocoPhillips Overseas Stock Savings Plan (the Plan) as modified to facilitate the participation of ConocoPhillips Australia Pty Ltd and ConocoPhillips (03-12) Pty Ltd in the Plan through the establishment of an Australian Sub-plan dated 8 February 1993; and
- excerpts from the 2009 Omnibus Stock and Performance Incentive Plan of ConocoPhillips (as established effective May 13, 2009).

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

The demerger

11. COPCo is a United States of America (USA) based company listed on the New York Stock Exchange and is a leading producer and marketer of natural gas.

12. The COPCo group's main business activities include:

- petroleum exploration and production;
- refining and marketing;
- natural gas gathering, processing and marketing; and
- chemicals and plastics production and distribution.

13. Immediately prior to the demerger, Phillips 66 was a wholly owned subsidiary of COPCo. At the time of the demerger, Phillips 66 was a USA resident company.

14. Prior to the demerger, members of the COPCo group of companies undertook a number of transactions to facilitate the demerger. These included an intra-group transfer of assets and liabilities to Phillips 66, including the subsidiaries responsible for COPCo's refining and marketing business, most of its natural gas gathering, processing and marketing business, its chemicals and plastics production and distribution business and other emerging businesses. Phillips 66 issued shares to COPCo as consideration for the transfer of the businesses.

15. As part of the demerger, COPCo will distribute its ownership interests in Phillips 66 to its shareholders as a reduction of capital. COPCo shareholders will receive one Phillips 66 share for every two COPCo shares held.

16. After the demerger, COPCo shareholders will own shares in both COPCo and Phillips 66. Phillips 66 will be a stand-alone USA publicly listed company.

17. Participants will continue to be employees of the COPCo Group following the demerger.

Employee Share Schemes

18. The COPCo Group operates a number of employee share plans.

US Plan

19. The applicant has advised that the US Plan operates as follows:

- (a) employees are granted rights called Restricted Stock Units (RSUs);
- (b) the RSUs are subject to a real risk of forfeiture;
- (c) each RSU entitles the holder to an ordinary share in COPCo upon satisfaction of specified vesting conditions;
- (d) prior to vesting, the RSU holder has no legal or beneficial interest in a COPCo share; and
- (e) upon vesting the ordinary COPCo shares delivered to employees are free of any sale or forfeiture conditions.

20. The terms and conditions of the US Plan provide that, in the event of certain corporate transactions, the number of RSUs granted to an employee shall be adjusted (a right to an adjustment in RSU entitlement). The Board of the Company is required to determine such adjustment as is appropriate to reflect the transaction and must ensure that the rights of each employee are not adversely affected.

21. At the demerger time, each RSU remains a right to receive an ordinary share of COPCo, subject to the terms of the original RSU. However, in accordance with the terms and conditions of the US Plan, the number of RSUs will be adjusted via the grant of additional RSUs to preserve the intrinsic value of the original award for each employee. The additional RSUs will be subject to the same conditions as the original RSUs.

Australian Plan

22. The applicant has advised that the Australian Plan operates as follows:

- (a) eligible employees are entitled to acquire COPCo shares (Employee Shares), subject to genuine sale restrictions, under an effective salary sacrifice arrangement;
- (b) Matching Shares, subject to a real risk of forfeiture, are granted in respect of Employee Shares acquired;
- (c) the Employee Shares and Matching Shares are held in an employee share trust (the Trust) until the sale restrictions and forfeiture conditions are satisfied (vesting); and
- (d) legal interest in the shares is transferred from the Trust to the employee at vesting.

23. At the demerger time, employees holding a beneficial interest in COPCo shares, acquired under the Australian Plan and held by the Trust, will receive a beneficial interest in one Phillips 66 share for every beneficial interest held by the employee in two COPCo shares. Immediately following the demerger, as the Phillips 66 shares are not subject to any vesting conditions, the Trust will distribute the Phillips 66 shares to those employees for nil consideration.

Ruling

US Plan

24. The demerger as described in paragraphs 11 to 17 will not cause an ESS deferred taxing point under section 83A-120 in respect of RSUs held by a participant.

25. Section 83A-340 applies to the right to an adjustment in RSU entitlement when, under the rules of the US Plan, additional RSUs are issued to participants upon the demerger taking place and Division 83A will apply as if that right had always been a right to acquire a beneficial interest in the shares related to the additional RSUs.

Australian Plan

26. The demerger as described in paragraphs 11 to 17 will not cause an ESS deferred taxing point under section 83A-115 in respect of COPCo shares held by the Trust for a participant.

27. Beneficial interests in Phillips 66 shares granted to a participant as a result of the demerger occurring are not ESS interests provided under an employee share scheme within the meaning of subsection 83A-10(2).

Capital Gains Tax

CGT event E5

28. CGT event E5 occurs when a participant becomes absolutely entitled to a Phillips 66 share held by the Trust which is at the time the trustee of the Trust allocates the shares to the participant (section 104-75).

29. Any capital gain or capital loss made by the participant as a result of CGT event E5 will be disregarded (paragraph 104-75(6)(a)).

30. Any capital gain the trustee makes arising from CGT event E5 will be included in the net income of the trust estate. Division 102 applies to a beneficiary of the trust estate (a participant) as if the beneficiary had a capital gain equal to their share of the capital gain. If the capital gain was a discount capital gain in the hands of the trust estate the beneficiary will include a capital gain equal to twice their share of the trust's capital gain in accordance with subsection 115-215(3).

Cost Base

31. The cost base of any new Phillips 66 shares allocated and distributed to a participant by the trustee of the Trust as a result of the demerger taking place will be determined using the market value substitution rule (section 112-20).

Trust

32. Immediately after the demerger the Trust continues to be an employee share trust for the purposes of subsection 130-85(4).

Commissioner of Taxation

27 June 2012

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.*

ESS interest and ESS deferred taxing point

33. Division 83A of the ITAA 1997 applies to ESS interests (shares, rights and stapled securities) acquired under an employee share scheme on or after 1 July 2009. Division 83A of the ITAA 1997 also applies to certain ESS interests acquired before 1 July 2009 under Division 83A of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997).

34. The COPCo shares and RSUs acquired by participants under the Australian or US Plans are ESS interests as defined under subsection 83A-10(1) of the ITAA 1997.

COPCo shares or RSUs acquired pre-1 July 2009

35. By reason of subsection 83A-5(2) of the IT(TP)A 1997, Subdivision 83A-C of the ITAA 1997 (and the rest of Division 83A of the ITAA 1997 to the extent that it relates to that Subdivision) applies in relation to COPCo shares or RSUs granted to a participant prior to 1 July 2009 under either the Australian Plan or the US Plan because:

- (a) the COPCo shares or RSUs were acquired (within the meaning of former Division 13A of the ITAA 1936) before 1 July 2009;
- (b) former subsection 139B(3) of the ITAA 1936 applied in relation to the COPCo shares or RSUs immediately before 1 July 2009 (the class of entities subject to this Ruling had not yet had a cessation time at the time of the demerger so, by definition, former subsection 139B(3) of the ITAA 1936 applied to the shares or RSUs immediately before 1 July 2009); and
- (c) the cessation time mentioned in former subsection 139B(3) of the ITAA 1936 and former section 139CA or former section 139CB for those COPCo shares or RSUs did not occur before 1 July 2009 (see above).

36. Where Subdivision 83A-C of the ITAA 1997 applies to an ESS interest, an amount will be included in the assessable income of a participant under subsection 83A-110(1) in respect of their ESS interest in the income year in which the ESS deferred taxing point occurs.

37. The ESS deferred taxing point for shares or rights is worked out under section 83A-115 of the ITAA 1997 or section 83A-120 of the ITAA 1997 respectively. However, because Subdivision 83A-C of the ITAA 1997 applies to the COPCo shares or RSUs acquired before 1 July 2009 by virtue of subsection 83A-5(2) of the IT(TP)A 1997, subsection 83A-5(4) of the IT(TP)A 1997 applies.

38. Subparagraph 83A-5(4)(b)(i) of the IT(TP)A 1997 provides that the ESS deferred taxing point for a share or right acquired before 1 July 2009 will be the cessation time mentioned in former subsection 139B(3) of the ITAA 1936, subject to subsection 83A-115(3) of the ITAA 1997 or subsection 83A-120(3) of the ITAA 1997 respectively.

39. Therefore, whether an ESS deferred taxing point arises as a consequence of the demerger will depend on whether a cessation time as mentioned in former subsection 139B(3) of the ITAA 1936 would result from the demerger.

40. The cessation time for a COPCo share or an RSU held by a participant is the earliest of:

- (a) when the share or RSU is disposed of;
- (b) for a COPCo share, the time any restriction on disposal ceases;
- (c) for an RSU, the time the right is exercised;
- (d) when the participant's employment ends; or
- (e) the end of the 10 year period starting when the participant acquired the share or RSU.

41. At the time of the demerger there is no cessation time and therefore no ESS deferred taxing point for RSUs or COPCo shares acquired by participants prior to 1 July 2009.

US Plan – RSUs acquired on or after 1 July 2009

42. RSUs, acquired by participants on or after 1 July 2009 under the US Plan, are ESS interests acquired under an 'employee share scheme' as they were awarded to employees of COPCo in relation to their employment (subsection 83A-10(2) of the ITAA 1997).

43. The ESS deferred taxing point for an RSU is the earliest of the times specified in subsections 83A-120(4) to (7) of the ITAA 1997, which include the following times:

- (a) when there is no real risk of forfeiting the RSU and any restrictions on disposal of the RSU no longer apply;
- (b) when the participant's employment with COPCo ends;
- (c) seven years after the participant acquired the RSU; or

- (d) when there is no real risk of forfeiting the RSU or the resulting COPCo share, and the US Plan no longer genuinely restricts exercise of the RSU or disposal of the resulting share.

44. As none of these occur at the time of the demerger, there is no ESS deferred taxing point at that time in respect of RSUs acquired on or after 1 July 2009 and held by a participant.

US Plan – allocation of additional RSUs

45. Participants in the US Plan have, from the time that their participation commences in the plan, various rights provided by that plan.

46. The terms and conditions of the US Plan govern how the plan operates. Those terms and conditions provide (among other things) for adjustments to be made to the number of stocks or awards issued to the participant to ensure that there is no disadvantage to participants should certain specified corporate transactions or reorganisations occur.

47. The allocation of additional RSUs to a participant due to the demerger taking place arises from the participant's entitlements under the US Plan. The additional RSUs are granted as a consequence of the participant's right under the US Plan not to be adversely affected by the demerger.

48. Section 83A-340 of the ITAA 1997 provides that where you acquire a beneficial interest in a right that later becomes a right to acquire a beneficial interest in a share, Division 83A will apply as if the right had always been a right to acquire the beneficial interest in the share.

49. In order for section 83A-340 of the ITAA 1997 to apply:

- the right acquired must be capable of becoming a right to acquire a beneficial interest in a share; and
- the right must become a right to acquire a beneficial interest in a share.

50. From the time of participation in the US Plan, participants have a right (which is the right to an adjustment in the number of RSUs allocated to the participant) which from the outset is capable of becoming a beneficial interest in a share if specified corporate transactions ever occur.

51. Upon the demerger taking place, additional RSUs are awarded to participants to preserve the intrinsic value of the original award, effectively converting the right to an adjustment into a right to acquire a beneficial interest in a share. As such, additional RSUs awarded to participants under the US Plan as a consequence of the demerger taking place are ESS interests acquired under an 'employee share scheme' as they are awarded to employees of COPCo in relation to their employment (subsection 83A-10(2) of the ITAA 1997).

Australian Plan –COPCo shares acquired on or after 1 July 2009

52. COPCo shares, acquired under the Australian Plan on or after 1 July 2009 and held by the Trust for the benefit of participants, are ESS interests acquired under an 'employee share scheme' as they were awarded to participants in relation to their employment (subsection 83A-10(2) of the ITAA 1997).

53. Section 83A-115 of the ITAA 1997 provides that the 'ESS deferred taxing point', if the ESS interest is a beneficial interest in a share, is the earliest of:

- (a) when there is no real risk of forfeiting or losing the ESS interest and any disposal restrictions which existed at the time the ESS interest was acquired no longer apply;
- (b) when the employment in respect of which the ESS interest was acquired ends; or
- (c) the end of the 7 year period starting when the ESS interest was acquired.

54. As none of these occur at the time of the demerger for a participant with COPCo shares, there is no ESS deferred taxing point at that time in respect of those COPCo shares.

Australian Plan – allocation of additional Phillips 66 shares

55. An ESS interest is acquired under an employee share scheme only if the ESS interest is acquired in relation to the employee's employment. The allocation of additional Phillips 66 shares to a participant as a result of the demerger is not a result of their employment, but as a consequence of their existing interest in the COPCo shares.

56. As such, the additional Phillips 66 shares allocated to a participant due to the demerger are not ESS interests acquired under an employee share scheme.

Employee Share Trust

Sole Activity Test

57. An 'employee share trust' (subsection 130-85(4) of the ITAA 1997) for an 'employee share scheme' (having the meaning given by subsection 83A-10(2) of the ITAA 1997) is a trust whose sole activities are:

- (a) obtaining shares or rights in a company; and
- (b) ensuring that ESS interests in the company that are beneficial interests in those shares or rights are provided under the employee share scheme to employees, or to associates of employees, of:
 - (i) the company; or
 - (ii) a subsidiary of the company; and
- (c) other activities that are merely incidental to the activities mentioned in paragraphs (a) and (b).

58. At the time of the demerger, the Trust will receive, distribute and sell shares in Phillips 66 as described at paragraph 23 above.

59. These activities that the Trust undertakes fall within the scope of paragraph 130-85(4)(c) of the ITAA 1997.

Capital Gains Tax

CGT event E5

60. CGT event E5 happens when a beneficiary becomes absolutely entitled to a CGT asset of a trust. A participant becomes absolutely entitled to the Phillips 66 shares when the Trustee allocates the shares to them (section 104-75 of the ITAA 1997).

61. The Trustee will make a capital gain if the market value of the Phillips 66 shares is greater than their cost base (subsection 104-75(3) of the ITAA 1997).

62. As the participants acquired their interest in the trust estate for no expenditure, any capital gain or capital loss made by a participant is disregarded (subsection 104-75(6) of the ITAA 1997).

63. The carve-out provisions in section 130-90 of the ITAA 1997 do not apply as the participant did not acquire a beneficial interest in the Phillips 66 shares as the result of the exercise of a right. The participant acquired their beneficial interest in the Phillips 66 shares as a result of the demerger.

64. Any capital gain arising from CGT event E5 will be included in the net income of the trust estate. A participant as beneficiary is assessable under Division 102 of the ITAA 1997 on so much of the share of the net capital gain of the trust estate as determined and adjusted by Subdivision 115-C of the ITAA 1997. Subsection 115-215(3) of the ITAA 1997 deems the participant to have made a capital gain referable to their attributable gain as calculated under section 115-225 of the ITAA 1997.

Cost base

65. Section 112-20 of the ITAA 1997 provides that the first element of the cost base and reduced cost base of a CGT asset acquired from another entity will be its market value (at the time of acquisition) if:

- (a) you did not incur expenditure to acquire it; except if CGT event D1 occurred or another entity did something that did not constitute a CGT event happening;
- (b) some or all of the expenditure incurred to acquire it cannot be valued; or
- (c) the taxpayer did not deal at arm's length with the other entity in connection with the acquisition.

66. As the participant acquired the new Phillips 66 shares without incurring expenditure, paragraph 112-20(1)(a) of the ITAA 1997 is satisfied and the market value substitution rule applies to the Phillips 66 shares. The first element of the cost base will be the market value of the Phillips 66 shares at the time of acquisition, which is when the employee becomes absolutely entitled to the shares (subsection 109-5(2) of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT cost base
- demerger
- employee share scheme
- employee share trust
- ESS deferred taxing point
- ESS interest

Legislative references:

- ITAA 1997 83A-10
- ITAA 1997 83A-110
- ITAA 1997 83A-115
- ITAA 1997 83A-120
- ITAA 1997 83A-340
- ITAA 1997 104-75
- ITAA 1997 109-5
- ITAA 1997 112-20
- ITAA 1997 115-215
- ITAA 1997 115-225
- ITAA 1997 130-90
- IT(TP)A 1997 83A-5
- TAA 1953
- Copyright Act 1968

ATO references

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