


CR 2019/67 - QANTM Group - equity participation scheme for principals

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Class Ruling

QANTM Group – equity participation scheme for principals

📌 Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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What this Ruling is about

1. This Ruling sets out tax consequences of the QANTM Intellectual Property Limited (QANTM) employee remuneration trust (ERT), established to facilitate an equity participation scheme for newly appointed Principals of QANTM or one of its subsidiaries (QANTM Group).
2. Full details of the scheme are set out in paragraphs 19 to 34 of this Ruling. Unless otherwise defined, capitalised terms in this Ruling take their meaning from the documents listed in these paragraphs.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

Note: By issuing this Ruling, the ATO is not endorsing this product. Potential participants must form their own view about the product.

Who this Ruling applies to

4. This Ruling applies to you, if you are a Principal who is invited to participate in the scheme outlined in paragraphs 19 to 34 of this Ruling, and you:
- are an Australian resident for taxation purposes
 - are employed by the QANTM Group as a newly appointed Principal of the QANTM Group
 - were not a shareholder in QANTM or you did not participate in the QANTM Group restructure prior to QANTM being listed on the Australian Securities Exchange
 - did not hold a substantial or controlling interest in the QANTM Group prior to becoming a Principal
 - participate in the ERT as part of your employment contract, and
 - hold Share Units on capital account (that is, you neither hold them as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1)).
5. In this Ruling, a person belonging to this class of entities is referred to as a Participant.
6. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 19 to 34 of this Ruling.

Note: Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

7. This Ruling applies from 1 July 2018 to 30 June 2023.

Ruling

8. The Participant is not assessable under section 6-5 or section 15-2 at the time the contribution is made by the employer to the trustee of the QANTM Employee Share Trust (the Trustee).

9. The Participant will include in their assessable income so much of the net income of the ERT estate to which they are presently entitled to under section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936). However, Division 6E of the ITAA 1936 modifies the operation of Division 6 of the ITAA 1936 for the purposes of excluding amounts relevant to capital gains, franked distributions and franking credits from the calculations of assessable income under section 97 (amongst other sections) of the ITAA 1936. Subdivisions 115-C and 207-B provide the corresponding taxation treatment for those capital gains, franked distributions and franking credits.

10. The Redemption Amount included as assessable income to the Participants under sections 6-5 or 15-2 is equal to the lesser of the initial Loan Amount used to acquire the Share Units by the Participant, or the market value of the Allocated Shares on the Crystallisation Date.

11. When the Share Units are redeemed or cancelled, CGT event C2 happens pursuant to section 104-25. The Participant makes a capital gain if the capital proceeds

from the ending are more than the cost base of the units. A capital loss occurs if the capital proceeds are less than the reduced cost base.

12. The capital proceeds (see section 116-20) with respect to CGT event C2 will include the Redemption Amount, whether paid in cash or property (being the Allocated Shares).

13. The cost base or reduced cost base of the Share Units will be reduced by the amount equal to any shortfall amount between the Redemption Amount and the initial Loan Amount (where the Redemption Amount is less than the initial Loan Amount), as at the Crystallisation Date, in accordance with subsections 110-45(3) and 110-55(6).

14. Where the Trustee of the ERT disposes of the Allocated Shares attributable to the Participant's Share Units (including transferring them to the Participant) resulting in a capital gain, the gain is included in the ERT's net income. The rules contained in Subdivision 115-C (Rules about trusts with net capital gains) will treat parts of the net income attributable to any net capital gain of the ERT as capital gains made by the Participant entitled to those parts when assessing the Participant as beneficiary, so the Participant can apply any capital losses against capital gains and the appropriate discount percentage (if any) to gains in accordance with the Subdivision.

15. A capital gain, from the happening of a CGT event C2, in relation to the ERT scheme as defined in paragraphs 18 to 33 of this Ruling that is included in the assessable income of the Participant is reduced under section 118-20 by the amount of the Redemption Amount that is included in the Participant's assessable income under section 6-5 or section 15-2.

16. If the Participant makes a capital gain on redemption of his or her Share Units and the units were acquired 12 months or more prior to CGT event C2 happening, the gain is a discount capital gain pursuant to Division 115.

17. The cost base or reduced cost base of the Allocated Shares provided to the Participant as at the Crystallisation Date will equal the market value at the time the Participant acquires the Allocated Shares (sections 110-25, 110-55 and 112-20).

18. Subsections 207-35(3) to (6) set out the circumstances in which a beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution 'flows indirectly' (within the meaning of Subdivision 207-B) through a trust to a resident that is an individual, they will, subject to being a 'qualified person', be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45). Where a Participant's total franking credits do not exceed \$5,000, the Participant will be deemed to be a qualified person and will be entitled to a franking credit in respect of Cash Distributions received that are attributed to the Allocated Shares attached to their Share Units.

Scheme

19. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

20. The scheme is an arrangement under which newly appointed Principals of the QANTM Group are offered the opportunity to participate in the ERT each year that they remain employed as a Principal of the QANTM Group. The ERT is not a public trading trust for the purposes of section 102R of the ITAA 1936.

21. The terms and conditions of the newly appointed Principal's employment with the QANTM Group are contained in their employment contract including the offer to participate in the scheme.

22. The terms and conditions of the scheme are set out in the QANTM Employee Share Trust Deed dated 19 April 2018 and amended by the Supplemental Deed dated 19 July 2018, including Schedules 1 to 6 which includes the Offer, the Loan Facility and the Loan Terms.

23. Under the terms of the Principal's employment contract, the Principal will be invited to participate in the scheme. The Trustee, as directed by QANTM, will make an Offer to the Principal to acquire Share Units under the Loan Facility.

24. The amount provided under the Loan Facility will be determined by the employment contract. The Participant will use the Loan Facility for the sole purpose of acquiring Share Units in the ERT. The loan will be non-recourse to the value of the Share Units and interest free. The Loan Amount is repayable at the end of the loan term, being the Crystallisation Date, and not before.

25. The Crystallisation Date is the earlier of:

- the last business day before the fifth anniversary of the date on which the Loan Amount is advanced to the Participant
- the date on which QANTM notifies the Trustee that the Allocated Shares are no longer Restricted Shares, and
- such other date as is set out in the Offer.

26. The Trustee will then acquire shares in QANTM which will be allocated to the Share Units acquired by the Participant on a one-to-one basis. The market value of the Share Units will equal the market value of the Allocated Shares at the time the Trustee acquires the shares.

27. As a unitholder in the ERT the Participant will be entitled to the following rights and benefits.

- all Cash Distributions paid in respect of the Allocated Shares referable to the Participant's Share Units
- the Participant may direct, in writing, the Trustee to vote on their behalf and how to exercise their voting rights
- the Participant will be presently entitled to so much of the Income of the Trust (if any) which is attributable to any Allocated Shares referable to the Participant's Share Units, including the proceeds of sale arising from the sale of the Allocated Shares, and transactions or events related to the Allocated Shares, and
- the Trustee must pay the Redemption Amount to the Participant in accordance with the Loan Terms.

28. The Allocated Shares are Restricted Shares in that they are subject to a restriction on disposal or any vesting conditions. The vesting conditions, set out in the employment contract, will be satisfied on the first of the following to occur:

- the expiration of the restriction period as provided in the Offer, being the Crystallisation Date
- the Principal dies or becomes permanently incapacitated
- the Principal resigns from employment

- the Principal's employment is terminated, or
- a notice is given by QANTM to the Trustee that the vesting conditions no longer apply to the Principal.

29. On the Crystallisation Date, the Participant is required to repay the Loan Facility, and the Trustee is required to pay the Redemption Amount. Under the documentation, a set off of the amounts payable by the Participant and the Trustee respectively can be effected. The amount to be repaid by the Participant will equal the lesser of the initial Loan Amount or the market value of the Share Units on the Crystallisation Date (those Share Units to be cancelled).

30. The Redemption Amount will equal the market value of the Share Units (which is referable to the market value of the Allocated Shares attributed to the Share Units on the Crystallisation Date). The Redemption Amount may be greater or lesser than the initial Loan Amount provided to acquire the Share Units.

31. Further, on the Crystallisation Date, the Participant's Share Units will become Forfeited Share Units in accordance with Schedule 4 – Loan Terms of the Trust Deed whereby the Trustee will as soon as practicable cancel or redeem the Forfeited Share Units.

32. When the Share Units become Forfeited Share Units the Participant (also referred to as the Borrower) will be taken to have repaid the Loan Facility in full and the Borrower will have no further liability or repayment obligation to the Trustee in respect of the Loan Facility; and there is no remaining amount payable by the Borrower to be offset against the Redemption Amount.

33. Where the Participant has paid an amount equal to the estimated pay as you go (PAYG) withholding a week before the Crystallisation Date, the Trustee's obligation to pay the Redemption Amount may be satisfied by the transfer of the applicable number of Allocated Shares to the Participant.

34. Where no payment is made by the Participant, as contemplated in paragraph 33 of this Ruling, the Trustee will pay a Redemption Amount to the Participant less any PAYG withholding amount. The Trustee will sell the relevant Allocated Shares to fund the payment of the Redemption Amount.

Appendix – Explanation

ⓘ *This Explanation 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.*

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Ordinary and statutory income

35. Subsection 6-5(1) states that your assessable income includes income according to ordinary concepts (ordinary income). Section 15-2 provides that your assessable income includes the value to you of all allowances, gratuities, compensation, benefits, bonuses and premiums provided to you in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by you.

36. At the time the employer makes a contribution to the ERT, a participant has only a right to participate in the ERT via the loan provided to the participant from the Trustee.

37. The Participant's entitlement to be paid the Redemption Amount arises at the Crystallisation Date and will be equal to the market value of the Allocated Shares attributed to the Share Units.

38. The Redemption Amount will be assessed to the Participant as income either under sections 6-5 or 15-2 as that amount will constitute a payment of salary or wages or the provision of a benefit or bonus in connection with the Participant's employment at the time the Redemption Amount is paid to the Participant.

39. The part of the Redemption Amount included as assessable income of the Participants under sections 6-5 or 15-2 will be that part of the Redemption Amount that is equal to the lesser of the:

- initial Loan Amount used to acquire the Share Units by the Participant, or
- market value of the Allocated Shares on the Crystallisation Date.

Trust income

40. The Participant will include in their assessable income so much of the net income of the ERT estate to which they are presently entitled to under section 97 of ITAA 1936.

41. Section 97, amongst other things, has the result of assessing beneficiaries on a share of the net income of the trust estate based on their present entitlement to a share of the income of the trust estate.

42. Division 6E of the ITAA 1936 modifies the operation of Division 6 of the ITAA 1936 for the purposes of excluding amounts relevant to capital gains, franked distributions and franking credits from the calculations of assessable income under section 97 (amongst other sections) of the ITAA 1936.

43. Subdivision 115-C and 207-B provide the corresponding taxation treatment for those capital gains, franked distributions and franking credits.

Capital gains and capital losses

44. The general capital gains and losses rules under Part 3-1 to Part 3-3 apply to CGT events in relation to the CGT assets which include intangible assets such as units in a unit trust.

45. Under Division 110, the cost base or reduced cost base of the Share Units acquired by the Participant will include the Loan Amount as determined under the Offer and Loan Facility.

46. Section 104-25 provides that CGT event C2 happens if ownership of an intangible CGT asset ends by it being redeemed or cancelled. Accordingly, when an Australian resident unit holder redeems his or her units or the units are cancelled there will be a CGT event. 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 reduced cost base.

47. The capital proceeds with respect to CGT event C2 will be the amount of the Redemption Amount received either as cash or the provision of shares by the Participant (see section 116-20).

48. Under subsection 104-10(1), CGT event A1 happens if the Trustee disposes¹ of a CGT asset, being Allocated Shares attributable to the Participant's Share Units. Where the disposal results in a capital gain², the capital gain is included in the ERT's net income. The rules contained in Subdivision 115-C treat parts of the net income attributable to any net capital gain of the ERT as capital gains made by the Participant entitled to those parts when assessing the Participant as beneficiary, so the Participant can apply any capital losses against capital gains and the appropriate discount percentage (if any) to gains in accordance with the Subdivision.

49. A capital gain resulting from a CGT event C2 happening in relation to the ERT scheme as defined in paragraphs 19 to 34 of this Ruling that is included in the Participant's assessable income is reduced under section 118-20 by the amount of the Redemption Amount that is assessed to the Participant's under section 6-5 or section 15-2 (see paragraphs 35 to 39 of this Ruling).

50. For the purposes of Division 115 (discount capital gains) the time of acquisition of the Share Units will be the date that the Share Units were acquired by the Participant.

51. If on the Crystallisation Date the market value of the Allocated Shares is less than the initial Loan Amount (the shortfall amount), the Participant is not required to repay the shortfall amount. Thus the Participant has indirectly received the shortfall amount as a reduction in the loan amount. The economic gain is within the meaning of 'recoupment' of section 20-25 because the Participant has received an amount to compensate their loss as a result of the loan being discharged in full by an asset that is worth less than the loaned amount.

¹ Subsection 104-10(2) provides that you dispose of a CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner.

² Subsection 104-10(4) provides that you make a capital gain if the capital proceeds from the disposal of that asset exceed its cost base, and you make a capital loss if those capital proceeds are less than the reduced cost base of the asset.

52. Accordingly, the shortfall amount is a 'recoupment' and therefore, will not form part of the Share Units cost base or reduced cost base in calculating any capital gain or capital loss under subsections 110-45(3) and 110-55(6).

Cost base of the Allocated Shares

53. The first element of a CGT asset's cost base is the total of money paid or required to be paid, and market value of property given or required to be given, in respect of acquiring that asset (at the time of acquisition), pursuant to section 110-25. If no money or property is given to acquire that asset, the market value substitution rule in subsection 112-20(1) operates to deem the first element of the cost base to be the market value of the property at the time it was acquired.

54. Where the Trustee transfers the Allocated Shares to the Participant in satisfaction of their obligation to pay the Redemption Amount, the Participant did not incur any expenditure to acquire the Allocated Shares.

55. As the Participant did not incur expenditure to acquire the Allocated Shares provided under the scheme, then the first element of the cost base or reduced cost base of the shares is the market value of the shares at the time of acquisition (subsection 112-20(1)). This cost base or reduced cost base will be used in the calculation of any capital gain or capital loss arising from a subsequent CGT event affecting the shares.

Entitlement to franking credits

56. A unitholder having a relevant share of the franked distributions of a unit trust (within the meaning of Subdivision 207-B) will not be entitled to a tax offset for their share of any franking credits attached to those distributions if any of the circumstances set out in section 207-150 apply. This includes the situation where the unitholder is not a qualified person in respect of those distributions for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.

57. Where the Participant's total franking credits on all of the dividends paid on shares that a taxpayer who is an individual holds or holds an interest in is less than \$5,000, then pursuant to former subsection 160APHT(1) of the ITAA 1936, the small shareholder exemption applies to the Participant. In such cases, the Participant is deemed to be a qualified person in relation to those dividends.

58. If paragraph 57 of this Ruling does not apply, the Participant will not be a qualified person, as the Participant does not have a vested and indefeasible interest in the corpus of the ERT under former section 160APHL of the ITAA 1936.

References*Previous draft:*

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2018/7

Legislative references:

- ITAA 1936 Div 6
- ITAA 1936 97
- ITAA 1936 102R
- ITAA 1936 Div 6E
- ITAA 1936 Div 1A of former Pt IIIAA
- ITAA 1936 former 160APHL
- ITAA 1936 former 160APHL(1)
- ITAA 1936 former 160APHT(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 15-2
- ITAA 1997 20-25
- ITAA 1997 Pt 3-1
- ITAA 1997 102- 5(1)
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 104-10(4)
- ITAA 1997 104-25
- ITAA 1997 Div 110
- ITAA 1997 110-25
- ITAA 1997 110-45(3)
- ITAA 1997 110-55
- ITAA 1997 110-55(6)
- ITAA 1997 112-20
- ITAA 1997 112-20(1)
- ITAA 1997 Div 115
- ITAA 1997 Subdiv 115-C
- ITAA 1997 116-20
- ITAA 1997 118-20
- ITAA 1997 Pt 3-3
- ITAA 1997 Subdiv 207-B
- ITAA 1997 207-35(3)
- ITAA 1997 207-35(4)
- ITAA 1997 207-35(5)
- ITAA 1997 207-35(6)
- ITAA 1997 207-45
- ITAA 1997 207-150
- ITAA 1997 Div 230
- ITAA 1997 977-50
- ITAA 1997 995-1(1)
- TAA 1953

ATO references

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