

TA 2009/18 - Discretionary Option Arrangement

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⚠ This document has changed over time. This version was published on *3 May 2024*



Taxpayer Alert

TA 2009/18

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which are of concern to the Tax Office. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the Tax Office's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Discretionary Option Arrangement

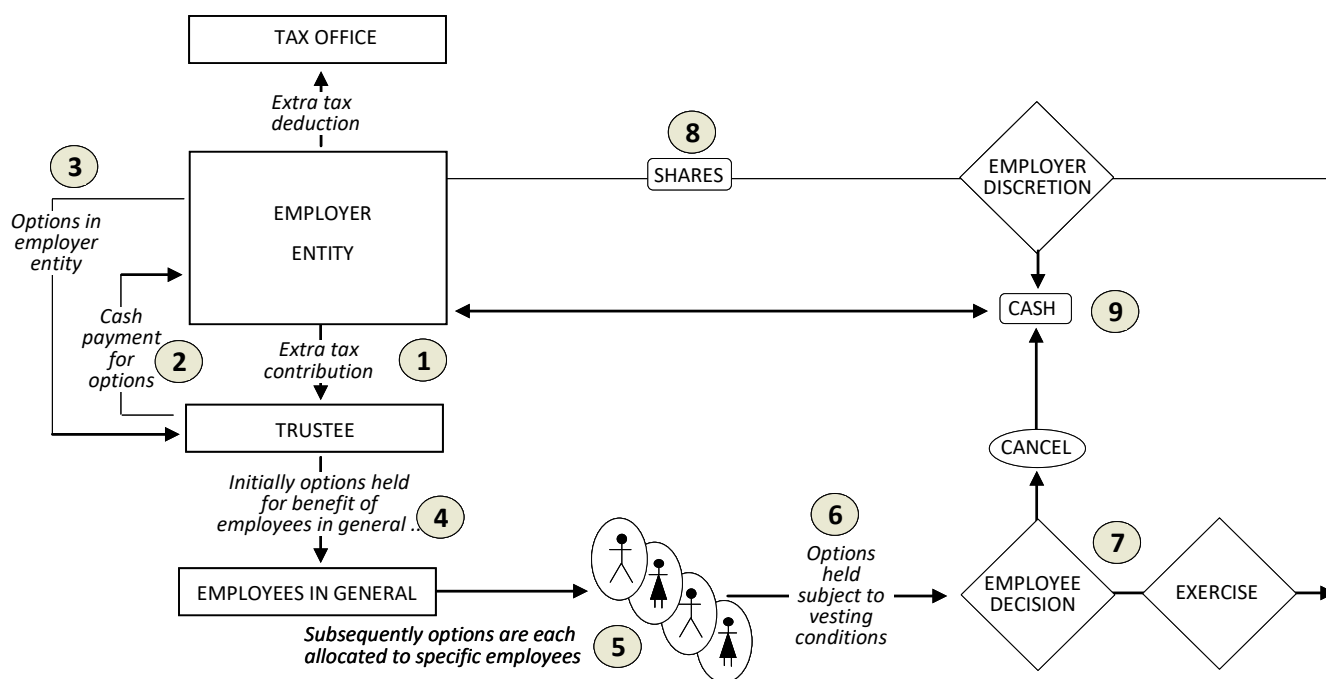
This Taxpayer Alert describes an arrangement where an employer attempts to artificially create an up front tax deduction by issuing a discretionary option to employees utilising a trust and round robin cash-flows. The employer has a discretion as to whether the employees will receive shares or cash from the arrangement and any tax for employees will be deferred until a later income year.

DESCRIPTION

The alert applies to arrangements with features substantially equivalent to the following:

1. The Employer (the Employer) makes an extra cash contribution to a Trustee of a Trust (the Trustee), in respect of acquisition of several discretionary options for employees, and claims this amount as a tax deduction.
2. The Trustee pays the cash contribution back to the Employer as consideration for acquiring several such options ('the options') from the Employer. The acquisition price of the option is determined in accordance with a valuation methodology adopted by the Employer.
3. The options may be exercised or cancelled.
 - An option that is exercised enables its owner to acquire a share in the Employer on the exercise of the option.
 - An option that is cancelled gives its owner a cash amount referable to the market value of a share in the Employer at the time the option is cancelled.
4. The legal and beneficial ownership of the options is initially held by the Trust for the benefit of employees of the Employer generally.
5. In a later financial year and at the direction of the Employer, the Trustee allocates each such option to a specific employee. At this time, the legal and beneficial ownership of the option passes from the Trustee to that employee (the employee).
6. The employee holds the option and can exercise or cancel the option in accordance with the option vesting conditions. The conditions may include performance hurdles, a minimum holding period, or the exercise of a discretion by the Employer to allow the option to be exercised or cancelled.
7. Once the vesting conditions have been satisfied, the employee may exercise or cancel the option. However, the Employer may at its discretion, do one of two things in respect of the option:
 - (a) allow the option to be exercised and issue a share to the employee; or
 - (b) cancel the option.
8. Where the option is exercised and a share is issued to the employee, the cost of the share to the employee is the option exercise price. The option exercise price is the market value of the share at the time the option is acquired by the Trustee.
9. Where the option is cancelled, the employer will pay to the employee a cash amount equal to the difference between the option exercise price and the value of a share in the Employer at the time the option is cancelled.

Diagram of a typical arrangement



FEATURES WHICH CONCERN US

The Tax Office considers that an arrangement which exhibits the features outlined above may give rise to taxation issues that include whether:

- the arrangement, or certain steps within it, may constitute a sham at general law;
- the Employer may have incurred the expenditure for the contribution it makes to the trustee, in order to entitle it to a deduction under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997), noting the circular flow of funds;
- the Employer may be assessable on the consideration it receives for issue of "Options" to the Trustee under section 6-5 of the ITAA 1997;
- the employee may be assessable on receipt of the "Options" under section 6-5 or 15-2 of the ITAA 1997;
- the provisions of Division 13A of the *Income Tax Assessment Act 1936* (ITAA 1936) (and any superseding legislation) may apply to the arrangement;
- the receipt of a cancellation payment on cancellation of options may be assessable income of the employee under section 6-5 or 15-2 of the ITAA 1997;
- the cancellation of the Options may constitute a CGT event C2 under section 104-25 of the ITAA 1997 for the employee or a CGT event C3 under section 104-30 of the ITAA 1997 for the employer;
- the arrangement may constitute a scheme to which the general anti-

avoidance rules in Part IVA of the ITAA 1936 apply;

- (i) the arrangement may result in the provision of fringe benefits for the purposes of the *Fringe Benefits Tax Assessment Act 1986*; and
- (j) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.

The Tax Office is currently reviewing these arrangements.

The Tax Office approach to the acquisition of options which is subject to a discretion and/or approval is contained in ATO ID 2007/66: Income Tax Employee Share Scheme: rights to acquire shares subject to shareholder approval.

At the time of the alert being issued, the new employee share scheme legislation Division 83A of the Income Tax Assessment Act 1997 was passed on 2 December 2009, and is yet to receive the Royal Assent.

Note 1: *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the Income Tax Assessment Act 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

Note 2: *Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 1800 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 86 (Fast Key Code 3 4).*

Note 3: *Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

Note 4: *Where appropriate, section 167 of the Income Tax Assessment Act 1936 (ITAA 1936) may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PS LA 2007/7 and PS LA 2007/24.*

Amendment history

Date	Comment
3 May 2024	Updated Tax Agent tip off hotline number
19 January 2024	Updated ATO tip-off hotline numbers

Subject references:

Arrangement
Anti-avoidance
Options
Fringe Benefit Tax
Part IVA

Legislative references:

Income Tax Assessment Act 1936
Part IVA
Division 13A
Income Tax Assessment Act 1997
Section 8-1
Section 6-5
Section 15-2
Part 3-1
Fringe Benefits Tax Assessment Act 1986
Section 136
Taxation Administration Act 1953
Division 290

Other references:

ATO ID 2007/66

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