

## **PRODUCT RULING - BR Prd 15/01**

This is a product ruling made under s 91F of the Tax Administration Act 1994.

### **Name of the Person who applied for the Ruling**

This Ruling has been applied for by Chorus Limited.

### **Taxation Laws**

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BG 1, CA 1, CE 1, CX 2, CX 10, CX 35, EW 3, EW 6, EW 31, GA 1, HC 6, and HC 7 and subpart CE.

### **The Arrangement to which this Ruling applies**

The Arrangement is the establishment of a long-term incentive plan (Plan) for senior executives of Chorus New Zealand Limited (CNZL).

The following draft documents (in the form as provided to Inland Revenue on 23 May 2014) constitute part of the Arrangement:

- letter of invitation from Chorus Limited (Chorus) to employees of CNZL (Invitation Letter);
- Chorus long term incentive plan rules (Rules);
- Chorus long term incentive plan trust deed (Trust Deed) to be entered into between Chorus and Chorus LTI Trustee Limited (Trustee) acting as trustee of the Plan;
- Chorus long term incentive plan loan agreement (Loan Agreement) to be entered into between the participant and CNZL; and
- Chorus long term incentive plan put option deed to be entered into between Chorus and Trustee.

Broadly, the Arrangement operates as follows:

- CNZL will advance an interest free loan to Trustee as agent for, and at the request of, the employee. Trustee will use this loan to acquire shares in Chorus on behalf of the employee.
- The shares will be held on trust during a restrictive period. In respect of shares held on behalf of an employee:
  - distributions are applied in partial repayment of the employee's loan; and
  - the employee is able to direct Trustee how to vote.
- At the end of the restrictive period, the employee's ability to receive legal title to the shares will depend on whether vesting criteria are met.
  - Where the vesting criteria are **met** legal title will vest in the employee. In addition, the employee will receive a bonus equal to the grossed up original loan amount. The bonus (or part thereof, depending on the outstanding loan balance) is used to fully repay the employee's loan.
  - Where the vesting criteria are **failed** legal title will not vest in the employee. The employee will not receive a bonus. The loan becomes repayable in 20 days. The employee and Trustee have put and call options (respectively) to require Trustee to purchase and the employee to sell (respectively) the employee's beneficial interest in the shares to Trustee for the outstanding loan amount.

Further details of the Arrangement are set out in the paragraphs below.

### **Objectives of the Plan**

1. The primary objective of the Chorus Group in establishing the Plan is to encourage executives to become shareholders in Chorus, thus aligning their interests with those of other shareholders. Clause 2 of the Rules states that the objectives of the Plan are to:
  - reward and retain key employees;
  - drive longer-term performance and alignment of incentives of participants with the interests of Chorus' shareholders; and
  - encourage longer term decision-making.

### **Invitation**

2. The Invitation Letter will be sent to certain employees of CNZL who are tax resident in New Zealand (potential Participants). The Invitation Letter details the terms of the proposed grant, including a loan amount offered to the Participant that must be used to acquire shares in Chorus, the Plan Shares being held in trust for a restrictive period, a target cash bonus amount and performance hurdles. The Invitation Letter also specifies that the grant is subject to the Rules, Trust Deed and Loan Agreement.

3. The potential Participant may accept the grant by signing and returning the acceptance form attached to the Invitation Letter within a prescribed timeframe. In accepting the grant, the Participant acknowledges that they are bound by the Plan Rules, and that such acknowledgement is also for the benefit of CNZL and Trustee, and is intended to be enforceable by CNZL and Trustee.
4. CNZL is a wholly owned subsidiary of Chorus. The Participants will not be associated with Chorus or CNZL for the purpose of the Act.

### **Terms of loan**

5. On acceptance of the grant, CNZL will advance an interest free loan to Trustee as agent for, and at the request of, the Participant (cl 2.1 of the Loan Agreement and cls 6.1, 6.3(a) and 6.3(b) of the Rules).
6. Trustee will be bound to use the loan amount to purchase or subscribe for new or existing ordinary shares in Chorus on behalf of the Participant (the Plan Shares) (cl 2.1(a) of the Loan Agreement and cls 5.2(b) and 6.2 of the Rules).
7. The loan will be limited recourse; that is, the recourse of CNZL (the lender) will be limited to the Plan Shares acquired with the proceeds of the loan (cl 2.1(d) of the Loan Agreement and cl 6.3(d) of the Rules). The Participant will have no liability in respect of the loan other than to the extent of their interest in the Plan Shares.
8. The loan will be repayable on the loan repayment date and otherwise in accordance with the Rules (cl 2.1(b) of the Loan Agreement). Except as otherwise provided in the Rules, a Participant may not prepay the loan balance (cls 2.1(b) and 2.1(c) of the Loan Agreement and cl 6.3(c) of the Rules). The Rules provide for repayment of the loan as follows:
  - The loan repayment date is the date that is 20 business days after the vesting date for legal title to the Plan Shares. The vesting date is set out in the Invitation Letter and is the date on which the performance hurdles are measured, currently set at three years from the commencement date (cl 16.9 of the Rules and the Invitation Letter).
  - A Participant must apply dividends (after deduction of any tax) to which the Participant is entitled in respect of that Participant's Plan Shares (as set out below) to partially repay the relevant Participant's loan amount, and the Participant instructs Trustee to do so (cl 6.4 of the Rules).
  - To the extent performance hurdles are achieved on the vesting date and the Participant is eligible to have legal title to the Plan Shares vested and a cash bonus, the Participant authorises CNZL to apply the after-tax bonus towards repayment of the loan balance (cls 10.1 and 10.3 of the Rules). Clause 10.4 of the Rules specifies that the Participant must repay the loan balance in respect of such Plan Shares on the loan repayment date in this manner.
  - To the extent hurdles are not met and the Participant is not eligible to have legal title to the Plan Shares vested, cl 10.4(b) of the Rules provides that cls 11 and 12 will apply. Clauses 11 and 12 each

relate to call and put options (discussed further below). On Trustee's exercising of the call or the Participant's exercising of the put, the Participant must transfer its beneficial interest in the relevant Plan Shares to the Trustee for an amount equal to the outstanding loan balance, which shall be settled by the transfer of the loan balance from the Participant to Trustee by way of novation of the Loan Agreement (cls 11.2, 11.3(c), 12.2 and 12.3(c) of the Rules).

### **Acquisition and holding of Plan Shares**

9. Trustee will acquire the Plan Shares either on-market or, if the Plan Shares are issued by Chorus or transferred from unallocated shares, at the volume weighted average price of Chorus shares on the NZX for the 10 trading day period before such issue or transfer (cl 7.2 of the Rules). No agreement to subscribe or purchase will be entered into by the Trustee before the relevant purchase, subscription or allocation of Plan Shares.
10. Trustee will hold the Plan Shares as trustee on behalf of the Participant pursuant to the Rules and the Trust Deed. On the vesting date, legal title to any Plan Shares the Trustee holds for a Participant will become eligible for vesting (cl 8.1 of the Rules). Trustee must maintain an account for each Participant detailing the number of Plan Shares and the loan balance (cl 8.2 of the Rules).
11. In respect of the Plan Shares, each Participant will be entitled to:
  - receive notices issued to shareholders by Chorus (cl 8.3(a) of the Rules);
  - exercise voting rights via instructing Trustee (cl 8.4 of the Rules); and
  - receive any distributions (cl 8.3(b) of the Rules); such distributions must be applied to reduce the relevant Participant's loan balance while Trustee holds legal title to that Participant's Plan Shares.
12. Except as otherwise specified in the Plan, Plan Shares are not transferrable while the Trustee holds them. No Participant may grant security over that Participant's interest in any Plan Shares (cl 8.5 of the Rules).
13. Three adjustments are provided for in cl 13 of the Rules:
  - If, before vesting, Chorus confers on shareholders the rights to acquire shares or other benefits or assets, Chorus's board may offer further shares to Trustee as agent for the Participants so that Participants receive a benefit that reflects the value of the distribution rights to ordinary shareholders.
  - If, before vesting, Chorus, pursuant to a bonus issue, issues ordinary shares to shareholders in a manner that maintains the existing relative voting and distribution rights of all holders of ordinary shares, a Participant will be entitled on vesting to receive additional shares as if the Participant's Plan Shares had participated in the bonus issue.

- If, before vesting, there is a reconstruction of the shares of Chorus, the Board may effect a similar reconstruction in relation to the Plan Shares held by Trustee for that Participant to ensure Participants are no better or worse off as a result of the reconstruction.
14. Plan Shares will be held by Trustee on behalf of the Participant pursuant to the Trust Deed. This will essentially be until legal title vests in the Participant following the vesting date or Trustee purchases the beneficial interest in the Shares. The trust will be a "complying trust", as defined in s HC 10.
15. If Trustee purchases the beneficial interest in any Plan Shares, Trustee will:
- retain them for future Plan issues (while the shares are unallocated, Trustee will not exercise any voting rights in respect of such shares and will waive rights and entitlements to any dividends on such shares in accordance with cl 2.4 of the Trust Deed); or
  - sell them in the market and use the proceeds to settle the loan (which Trustee rather than the Participant will at that time owe to CNZL); or
  - exercise a put option to sell the Plan Shares back to Chorus for consideration equal to the loan balance outstanding, which Trustee can then use to settle the loan balance.
16. If Trustee has any surplus funds on the winding up of the Trust, whether by reason of any sale of Plan Shares at a price greater than the price paid by Trustee or otherwise, Trustee may distribute such funds as Trustee so wishes, provided no funds shall be distributed to Chorus (cl 5.2 of the Trust Deed).

### **Performance hurdles and vesting**

17. The provisional hurdles are:
- Tranche 1 – Chorus's total shareholder returns (TSR) from commencement of the Plan until the restrictive period ends must be greater than the 50th percentile TSR of NZX50 companies. If this hurdle is met, legal title in the shares will transfer to participants on a straight-line basis, from 50% transfer at the 50th percentile to 100% transfer, if the TSR is equal to the 75% percentile.
  - Tranche 2 – Chorus's TSR must be 10.4% or greater per year for legal title in all shares to be transferred.
18. The performance hurdles will be finalised around the time of the issue of the Invitation Letter to ensure the hurdles are appropriate at that time. The hurdles will be set at a level that is intended to push the executives to perform while being achievable and not unrealistic.

### ***If the performance hurdles are achieved***

19. Provided the Participant remains employed at the end of the restrictive period (cl 9.2 of the Rules) and to the extent performance conditions are met, Chorus will procure that a cash bonus equal to the grossed up value

of the original loan is paid by CNZL to the Participant in respect of each Tranche (Invitation Letter and cls 7.1 and 10.1 of the Rules).

20. Where Chorus is required to procure the bonus for the Participant in accordance with the Plan, CNZL will pay the Participant the bonus pursuant to the employment contract entered into between CNZL and the relevant Participant.
21. The after-tax amount of the bonus will be paid to Trustee and applied to repay the loan balance, regardless of Chorus's share price at that time (cl 10.1 of the Rules). Any excess amount of bonus will be paid directly to the Participant. An excess will arise if dividends have previously been derived by the Participant on the Plan Shares and used, in compliance with the Rules, to partially repay the loan.
22. Trustee will transfer legal title to the Plan Shares to the Participant on repayment of the loan (cls 10.3 and 10.4 of the Rules).

***If the performance hurdles are not met***

23. To the extent performance conditions are not met, no or a reduced cash bonus will be paid (ie, vesting is proposed to be progressive in relation to Tranche 1) (cl 10.2 of the Rules).
24. Clauses 11.1 and 12.1 of the Rules provide that Trustee will grant a put option to each Participant in respect of each Participant's beneficial interest in the Plan Shares in consideration for the grant of a call option by each Participant to Trustee in respect of each Participant's beneficial interest in the Plan Shares. The options are effectively exercisable where vesting criteria are not met.
25. Trustee may exercise a call option requiring the Participant to sell their beneficial interest in the Plan Shares to Trustee for an amount equal to the loan balance. The purchase price under the call option will be settled by the transfer of the loan balance from the Participant to Trustee by way of novation of the Loan Agreement (cls 11.1 and 11.2 of the Rules). Therefore, after novation, the loan will be owed by Trustee to CNZL.
26. Failing exercise of the call option, the Participant can exercise an equal and opposite put option requiring Trustee to purchase the beneficial interest in the Plan Shares from the Participant on the same basis (cls 12.1 and 12.2 of the Rules). The put option can be exercised only in limited circumstances where the performance hurdles are not met and the call option has not been exercised (cl 12.3 of the Rules). The Participants cannot exercise the put option if the hurdles are met but the share price has fallen.
27. Because the consideration for the transfer of the Participant's beneficial interest in Plan Shares under the call and put options is an amount equal to the loan balance, it is unlikely one or other will not be exercised if the performance hurdles are not met. If, for whatever reason, no option is exercised, the loan will become due on the loan repayment date regardless. Accordingly, the Participant will be required to repay the loan or CNZL will be able to take legal steps to execute against the shares.

## **Cessation of employment**

28. If the Participant ceases to be employed as a result of an involuntary event (eg, death, redundancy or ill health) before the restrictive period ends, the vesting date will be brought forward and an apportionment made to determine the number of shares eligible for immediate transfer of legal title (cl 9.1 of the Rules). If the Participant ceases to be employed for any other reasons or otherwise elects to cease participating in the Plan, then the Participant will not be eligible for a cash bonus and the Plan Shares will be subject to cls 11 and 12 of the Rules (ie, as if the performance hurdles had not been met).

## **Conditions stipulated by the Commissioner**

This Ruling is made subject to the following conditions:

- a) The value of the Plan Shares on the date Trustee acquires them on behalf of the relevant Participant will equal the price payable by the Participant for those Plan Shares.
- b) The final executed documents will not be materially different to the draft documents provided to Inland Revenue on 23 May 2014.

## **How the Taxation Laws apply to the Arrangement**

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows:

- a) Trustee's purchase of Plan Shares on behalf of the Participants will not give rise to any income to the Participants under subpart CE.
- b) Cash bonuses CNZL pays to eligible Participants will be income of the Participant under s CE 1(1)(a).
- c) The transfer of legal title in the Plan Shares to Participants will not result in the Participants deriving:
  - income under ordinary concepts for the purpose of s CA 1(2);
  - income in connection with their employment under s CE 1(1); or
  - beneficiary income under s HC 6.
- d) Where Trustee derives Chorus distributions on Plan Shares that are held on behalf of Participants, such distributions will constitute "beneficiary income" of the relevant Participant in accordance with s HC 6 and not "trustee income" in accordance with s HC 7.
- e) When the Participant transfers their beneficial interest in Plan Shares to Trustee following exercise of the call or put option:
  - the Participant will not derive any income under s CE 1; and
  - no fringe benefit will arise under s CX 2.

- f) The Plan, including the share acquisition, loan, bonus and options, but excluding any market purchase of shares by Trustee, is a "financial arrangement" as defined in s EW 3.
- g) The Participants must use Determination S33 to determine amounts solely attributable to the Shares, Put Options, Call Options and Employment Contracts (as defined in Determination S33) for the purposes of s EW 6(2).
- h) If a put or call option is exercised in accordance with the Plan, the base price adjustment calculated in accordance with s EW 31(5) on novation of the Loan Agreement will be nil for the Participant, provided Determination S33 is applied.
- i) Sections BG 1 and GA 1 do not apply to the Arrangement.

**The period or income year for which this Ruling applies**

This Ruling will apply for the period beginning on 4 February 2015 and ending on 31 December 2018.

This Ruling is signed by me on the 4th day of February 2015.

**Howard Davis**  
Director (Taxpayer Rulings)