



# ***CR 2004/77 - Income tax: United Utilities Public Limited Company (PLC) Performance Share Plan***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2003*



## Class Ruling

### Income tax: United Utilities Public Limited Company (PLC) Performance Share Plan

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#### **Preamble**

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVA 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**

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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. Section 139CD of the *Income Tax Assessment Act 1936* (ITAA 1936)

#### **Class of persons**

3. The class of persons to which this Ruling applies is Australian resident employees (the participating employees) of United Utilities Australia Pty Ltd and United Utilities MacArthur Operations Pty Ltd (the employer companies) who participate in the United Utilities PLC Performance Share Plan (the PSP).

#### **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 in paragraphs 10 to 17.

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

- 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- this Ruling may be withdrawn or modified.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

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8. This Ruling applies to the income years ended 30 June 2004, 30 June 2005 and 30 June 2006, subject to the operation of paragraph 9.

## Withdrawal

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9. This Ruling is withdrawn on and ceases to have effect after 15 July 2005. The Ruling continues to apply in respect of the tax law ruled upon to all persons within the specified class who enter into a specified arrangement during the term of the Ruling. Thus the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to the withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

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10. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or 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 the arrangement are:

- (a) the application letter from Freehills dated 24 February 2004 requesting a Class Ruling on behalf of the company in relation to the PSP;
- (b) the Articles of Association (the articles) of United Utilities PLC (the company);
- (c) the Rules of the PSP (the rules);
- (d) a copy of the decision of McLelland J of the New South Wales Supreme Court in *Norman v Norman* (1990) 19 NSWLR 314;
- (e) an email dated 11 May 2004, providing information on the employer company, the date of withdrawal of the Ruling and the date on which share options were issued under the PSP;
- (f) an email dated 13 May 2004 confirming information provided in the email dated 11 May 2004 and proposing a later date for the withdrawal of the Ruling; and
- (g) an email and attachments dated 1 July 2004 proposing an amendment to the years of effect, advising the names of the employer companies and providing their consent to being identified in this Ruling.

11. The company is incorporated in the United Kingdom and its shares are listed on the London Stock Exchange. Until 26 August 2003, the company had only one class of ordinary shares on issue. On 26 August 2003, an Extraordinary General Meeting of the company passed a resolution to issue A shares in two tranches, with the second tranche to be offered in June 2005.

12. The articles of the company set out the rights and restrictions attaching to the A shares:

- 50 pence per share par value for A shares compared to £1 per share for ordinary shares;
- holders of A shares are entitled to vote at any general meeting of the company on the same basis as ordinary shareholders. However, holders of such shares will have only one vote for every two shares held compared to holders of ordinary shares who have one vote for each share held;

- a shares carry rights to be paid dividends paid out of profits equal to one half of the dividend paid on ordinary shares;
- on a return of capital as a result of a winding up of the company or otherwise, holders of A shares are entitled to a distribution of profits or assets equal to one half that to which holders of ordinary shares are entitled;
- on a capitalisation issue of shares or debentures, holders of A shares are entitled to be issued with one half of the number of shares or debentures to which holders of ordinary shares are entitled and,
- if the company makes any further allotments or issues any further shares in connection with a rights or other issue, holders of A shares are entitled to be allotted or issued with half the number of shares to which ordinary shareholders are entitled.

13. The A shares issued under this article were offered to the public and have been listed on the London Stock Exchange.

14. The articles further provide that each holder of A shares as at 2 June 2005 shall be entitled to subscribe for further A shares on a one-for-one basis at a subscription price of £1.65 per share. The shareholder will be able to exercise that right from 7 June 2005 until 29 June 2005.

15. From the close of business on 6 July 2005, all A shares will be consolidated into ordinary shares on the basis of two A shares into one ordinary share. These new ordinary shares will have the same par value of £1 as other ordinary shares and will rank *pari passu* with existing ordinary shares, with the exception that they will not be able to receive any final dividend for the financial year ending 31 March 2005. However, they will be able to receive dividends as if they had been fully paid up with effect from 1 April 2005.

16. The PSP was established in 1996. Under the PSP, United Utilities Employee Share Trust Limited, as trustee of the PSP, makes discretionary awards of options to acquire ordinary shares in the company to eligible employees. Under the rules, an ordinary share is defined as 'a fully paid ordinary share (of whatever class) in the capital of the Company'. Accordingly, options issued under the PSP are options over both A shares and ordinary shares in the company.

17. The participating employees are current residents of Australia, employed by the employer companies. The company proposes to grant options under the PSP to these employees to acquire A shares in the company.

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## Ruling

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*All provisions mentioned hereinafter relate to the ITAA 1936 unless stated otherwise.*

18. Options to acquire A shares issued by the company to the participating employees under the PSP, are rights to acquire ordinary shares for the purposes of determining whether rights issued under an employee share scheme are qualifying rights pursuant to section 139CD.

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## Explanation

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19. Division 13A of Part III (Div 13A) provides for the taxation treatment of shares and rights acquired under an employee share scheme. The scheme of Div 13A provides for concessional taxation treatment of such shares or rights provided they satisfy certain requirements.

20. Those requirements include those set out in section 139CD which provides that certain conditions must be satisfied before shares or rights will be qualifying shares or rights. Further, subsection 139CD(4) provides that one of the conditions that must be satisfied is that rights issued under an employee share scheme must be rights to acquire ordinary shares.

21. Div 13A does not define what is an ordinary share. Further, the general definition provisions in subsection 6(1) and section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) do not contain a definition of ordinary share. Therefore, to determine whether an A share in the company is an ordinary share for the purposes of subsection 139CD(4) we look to other sources to determine the ordinary or common usage of that term.

22. Div 13A was enacted as a replacement for section 26AAC which covered the taxation treatment of employee share schemes and generally applied up to March 1995. Subparagraphs 26AAC (4A)(d)(ii) and (iii) required that all shares available for acquisition under such a scheme be ordinary shares and rights to acquire shares be rights to acquire ordinary shares.

23. The Explanatory Memorandum to Taxation Laws Amendment Bill (No. 5) 1988, (TLAB (No. 5) 1988), which introduced subsections 26AAC(4A) to 26AAC(4F), stated that '...all shares, including shares that may be acquired under a right, are ordinary shares'. This requirement was designed to ensure that holders of shares offered under an employee share scheme were not disadvantaged in respect of voting rights in comparison with similar shares offered to the public by the employing companies.

24. Taxation Ruling IT 2516, which deals with the taxation treatment of employee share acquisition schemes under section 26AAC also refers to voting rights in relation to ordinary shares when it states in paragraph 11, that 'Shares would be considered to be 'ordinary shares' where they have the same voting rights as ordinary shares offered to the public'.

25. Shareholders in the company who hold those shares classed as ordinary shares are entitled to vote at general meetings on the basis of one vote for every share held. Shareholders in the company who hold A shares are also entitled to vote at general meetings but only on the basis of one vote for every two shares held. This suggests that such voting rights are similar but not identical to those attaching to ordinary shares in the company.

26. The *Australian Oxford Dictionary* defines ordinary shares as 'shares entitling holders to a dividend from net profits (cf. *preference shares*)'. Further, the dictionary defines preference shares as 'shares or stock whose entitlement to dividends takes priority over that of ordinary shares.' These definitions suggest that, in determining what is an ordinary share, it is also appropriate to consider the dividend rights attaching to various classes of shares.

27. McLelland J in *Norman v Norman* (1990) 19 NSWLR 314, when considering whether certain shares were ordinary shares noted at 315 that: 'The expression "ordinary shares" is [not] defined ... in the *Companies Act 1961*, which was in force at the time of the incorporation of the company. Counsel were unable to refer me to any authority in which the expression has been defined'. However, he further noted at 316 that: 'In my opinion in ordinary usage the meaning of the expression "ordinary shares" is, and was in 1971, shares other than preference shares.'

28. Although there is no relevant Australian legislative definition of ordinary share, the distinction between ordinary and preference shares is implicit in section 254G of the *Corporations Act 2001*, subsections (1) and (2) of which state:

- (1) A company may:
  - (a) convert an ordinary share into a preference share;  
and
  - (b) convert a preference share into an ordinary share.
- (2) A company can convert ordinary shares into preference shares only if the holders' rights with respect to the following matters are set out in the company's constitution (if any) or have otherwise been approved by special resolution of the company:
  - ...
  - (e) priority of payment of capital and dividends in relation to other shares or classes of preference shares.

29. An interpretation that ordinary shares are shares that are not preference shares is supported by the definitions of ordinary share and preference share published by the Australian Stock Exchange on its website in its *Glossary of Sharemarket Terms*, the definitions being current as at 8 July 2004 (last reviewed on 21 August 2003):

- **ordinary share**  
... A class of shares which have no preferential rights as to either dividends out of profits or capital on a winding up.
- **preference shares**  
Shares that rank before ordinary shares in the event of liquidation of the issuing company and that usually receive a fixed rate of return.

30. This distinction is also made in the Eleventh Edition of *Ford's Principles of Corporations Law*, which states at paragraph 17.370 that, 'for example, if one class of shareholder is not to be paid a dividend in any year unless the holders of a preferred class have enjoyed a certain minimum dividend in that year, the shares carrying priority are called *preference shares* and the others are called *ordinary shares*.'

31. The distinction between ordinary and preference shares is further observed in the *Income and Corporation Taxes Act 1988* (Chapter 1) (UK) which is relevant to the company. Section 832 of that Act, headed 'Interpretation of the Tax Acts', contains a definition that, 'ordinary share capital, in relation to a company, means all the issued share capital (by whatever name called) of the company, other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of the company.'

32. In concluding that options to acquire A shares in the company are rights to acquire ordinary shares for the purposes of subsection 139CD(4), we have referred to the scheme of Div 13A and to the common usage of the term ordinary share. The following are the main factors referred to in arriving at that conclusion:

- it is clear that A shares in the company are not preference shares.
- A shares have essentially the same (although not identical) voting rights as those shares described by the company as ordinary shares.
- A shares which are the subject of options under the PSP are also issued to members of the public and as such, employees who participate in the PSP have the same voting and dividend rights as members of the public who acquire A shares in the company.
- as described in paragraph 15 of the Arrangement, all A shares whether held by employees or members of the public will be consolidated into ordinary shares in the company from 6 July 2005.



## Detailed contents list

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

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### Commissioner of Taxation

28 July 2004

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

CR 2001/1; TR 92/1; TR 97/16;  
IT 2516

*Subject references:*

- employee share scheme
- ordinary shares

*Legislative references:*

- ITAA 1936 6(1)
- ITAA 1936 13A
- ITAA 1936 26AAC
- ITAA 1936 26AAC(4A)
- ITAA 1936 26AAC(4A)(d)(ii)
- ITAA 1936 26AAC(4A)(d)(ii)
- ITAA 1936 26AAC(4B)
- ITAA 1936 26AAC(4C)
- ITAA 1936 26AAC(4D)
- ITAA 1936 26AAC(4E)
- ITAA 1936 139CD
- ITAA 1936 139CD(4)

- ITAA 1997 995-1

- Corporations Act 2001 254G(1)

- Corporations Act 2001 254G(2)

- Income and Corporation Taxes Act 1988 (Chapter 1) (UK) 832

- Copyright Act 1968

*Case references:*

- Norman v Norman (1990)  
19 NSWLR 314

*Other references:*

- Australian Oxford Dictionary, 1999, Oxford University Press, Melbourne
- Explanatory Memorandum to Tax Laws Amendment Bill (No. 5) 1988
- Ford's Principles of Corporations Law 2003, Eleventh Edition, H.A.J. Ford, R.P. Austin and I.M. Ramsay, Butterworths

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ATO references

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