CR 2023/43 - Australian Unity Limited - employee share scheme - Employee Mutual Capital Instrument Program

Status: **legally binding**

Class Ruling

Australian Unity Limited – employee share scheme – Employee Mutual Capital Instrument Program

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.

Table of Contents **Paragraph**

What this Ruling is about

1. This Ruling sets out the income tax consequences for employees of Australian Unity Limited (AUL) who acquire rights to Mutual Capital Instruments (MCIs) issued by AUL (AUL MCIs) under a Long Term Variable Compensation plan (Plan).

2. Details of this scheme are set out in paragraphs 21 to 44 of this Ruling.

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 acquirers must form their own view about the product.

Who this Ruling applies to

4. This Ruling applies to you if you are an employee of AUL who:

- acquired a right to an AUL MCI (Right) issued by AUL under the Plan, and
- is a resident of Australia as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936).

5. 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 21 to 44 of this Ruling.

Status: **legally binding**

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

When this Ruling applies

6. This Ruling applies from 1 July 2021 to 30 June 2022.

Ruling

Rights to mutual capital instruments

7. The Plan is an employee share scheme as defined in subsection 83A-10(2).

8. At the time the Right is acquired by you, it is not an ESS interest but an indeterminate right pursuant to section 83A-340. When that Right vests and is settled with an AUL MCI, it is a right to acquire a beneficial interest in an AUL MCI and is an ESS interest (subsection 83A-10(1)). In these circumstances, the Right is treated as if it had always been an ESS interest (subsection 83A-340(2)).

9. Subdivision 83A-B will apply to the Right you acquired (subsection 83A-20(1)).

10. Your assessable income for the income year you acquired the Right includes the discount given in relation to the AUL MCI at the time you acquired the Right (subsection 83A-25(1)).

11. The AUL MCI is not an ordinary share for the purposes of subsection 83A-45(2).

12. You are not entitled to a reduction of amounts to be included in your assessable income pursuant to section 83A-35 in respect of the Right you acquired (paragraph 83A-35(1)(b) and subsection 83A-45(2)).

13. Subdivision 83A-C will not apply to the Right you acquired (paragraph 83A-105(1)(b)).

14. No shortfall penalty will be imposed pursuant to Subdivision 284-B of Schedule 1 to the *Taxation Administration Act 1953* (TAA) if your assessment of an earlier income year is amended to include an amount in relation to Rights that vests and is settled with an MCI.

15. Division 83A will not apply if the Right is settled in cash. The cash payment will be included in your assessable income in the income year you receive the payment (section 6-5).

Dividend Equivalent Payments

16. Subdivision 83A-B will apply where you receive a dividend equivalent payment in respect of the number of Rights to AUL MCIs that vest (Dividend Equivalent Payment) delivered in AUL MCIs (subsection 83A-20(1)).

17. Your assessable income for the income year you received a Dividend Equivalent Payment delivered in AUL MCIs includes the discount given in relation to the AUL MCI at the time you acquired it (subsection 83A-25(1)).

18. You are not entitled to a reduction of amounts to be included in your assessable income pursuant to section 83A-35 in respect of the Dividend Equivalent Payment delivered in AUL MCIs (paragraph 83A-35(1)(b) and subsection 83A-45(2)).

19. Subdivision 83A-C will not apply to the Dividend Equivalent Payment delivered in AUL MCIs (paragraph 83A-105(1)(b)).

20. Division 83A will not apply if the Dividend Equivalent Payment you receive is delivered in cash. The cash payment will be included in your assessable income in the income year you receive the payment (section 6-5).

Scheme

21. 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.

Background

22. AUL is the ultimate holding company of the Australian Unity Group (AUL Group) and is a resident of Australia as defined in subsection 6(1) of the ITAA 1936.

23. The AUL Group is a provider of national health, wealth and living services to more than 700,000 Australians, including its members.

24. AUL is a mutual entity limited by shares and guarantee that is governed by and for the benefit of its members, which comprise eligible customers and employees.

25. Rule 3.1 of the Constitution for AUL, adopted on 27 October 2009 and last amended 27 October 2021 (Constitution) provides for 3 classes of membership, being:

- non-shareholder members
- shareholder members (other than MCIs), and
- shareholder members (MCIs).

26. The non-shareholder members are eligible customers and employees of AUL. The liability under the guarantee of each non-shareholder member is limited to $1 per member for current members and continues for a period of one year following cessation of membership.

Australian Unity Limited Mutual Capital Instruments

27. In 2019, amendments were made to the *Corporations Act 2001* (Corporations Act)[1] to allow mutual entities to raise share capital through the issue of MCIs in a manner that does not trigger a demutualisation.

28. The Constitution was amended in October 2019 in accordance with the relevant amendments to the Corporations Act to allow AUL to issue MCIs.

29. Rule 3.4 of the Constitution outlines the rights and conditions in respect of MCIs AUL may issue. AUL has since issued 2 prospectuses offering AUL MCIs, dated 7

[1] *Treasury Laws Amendment (Mutual Reform) Act 2019* inserted Part 2B.8 (sections 167AB to 167AJ) into the Corporations Act.

December 2020[2] and 11 October 2021[3], which further outlined the terms and conditions of AUL MCIs.

30. AUL MCIs are a perpetual instrument which can only be issued as a fully-paid share.

31. Dividends paid on AUL MCIs are discretionary and non-cumulative, and paid at a fixed annual rate as outlined in the relevant prospectus.

32. Holders of AUL MCIs have preferential rights in a winding-up by being entitled to receive the following payments before any return of capital or distribution to holders of ordinary shares or other class of securities ranking behind AUL MCIs or to a non-shareholder member:

- the amount of any dividends due but unpaid, and
- the face value of the AUL MCI.

33. AUL had MCI share capital of $342 million as at 31 December 2022.

34. AUL MCIs are listed on the Australian Securities Exchange under the code AYUPA.

Long Term Variable Compensation Plan

35. AUL introduced the Plan titled 'Program, Description and Rules Financial Year 2022' (Plan Rules) for eligible AUL employees which is governed by the Plan Rules. This Plan commenced in 2022, with an initial grant date of 31 January 2022.

36. Participation in the Plan is by annual invitation. Participants will be nominated annually having regard to performance, future potential and retention risk. Eligibility is determined by the AUL Board.

37. Participants may accept the invitation to participate in the Plan by returning the completed application form to AUL who will then notify the participant if and when their application is accepted.

38. Participants acquire Rights which convert to AUL MCIs upon satisfaction of the vesting conditions at the vesting date unless the Board determines in its absolute discretion to pay the participant a cash consideration in lieu of the issue or transfer of AUL MCIs equal to the participant's entitlement.

39. No issue price will be payable by the participant upon grant of the Right or on vesting of the AUL MCI.

40. Rights do not carry any rights to receive dividends prior to the vesting date.

41. At the vesting date, at the discretion of the AUL Board, and if specified in the relevant documentation, participants may be entitled to receive a Dividend Equivalent Payment delivered in MCIs or cash in respect of the number of Rights to AUL MCIs that vest.

42. The amount of the Dividend Equivalent Payment is equal to the dividends that would have been paid on the AUL MCIs between the date the Right was granted and the vesting date had a participant held the AUL MCIs during that period.

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[2] Prospectus relating to an offer of Australian Unity Limited Mutual Capital Instruments at $100 each to raise $105 million, with the ability to raise more or less.

[3] Prospectus relating to an offer of Australian Unity Limited Mutual Capital Instruments at $103 each to raise $160 million, with the ability to raise more or less.

43. The Plan Rules give AUL the ability to reduce any proposed grant of Rights or Dividend Equivalent Payments (including to zero). AUL may also, after the vesting date, recover any vested AUL MCIs or paid Dividend Equivalent Payments.

44. On resignation or termination, the participant will lose their eligibility to Rights that have not met relevant vesting conditions. In the case of redundancy or retirement (and in any other circumstances), the participant will retain their eligibility to receive Rights that have not met relevant vesting conditions.

Commissioner of Taxation
2 August 2023

Appendix – Explanation

❶ ***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.***

Table of Contents **Paragraph**

Rights settled with a mutual capital instrument

ESS interest

45. An ESS interest in a company is a beneficial interest in a share in the company or a right to acquire a beneficial interest in a share in the company (subsection 83A-10(1)).

46. A share in a company is defined in subsection 995-1(1) as being 'a share in the capital of the company, and includes stock'.

47. An MCI is a specific type of security to allow mutual entities to raise permanent capital without giving up their status as a mutual entity. AUL raised capital by issuing MCIs which are perpetual, fully-paid mutual capital instruments. Therefore, an AUL MCI is an ESS interest as it represents a share in the capital of AUL.

48. Consequently, a Right that vests and is settled with an AUL MCI is a right to acquire beneficial interest in an AUL MCI and is therefore also an ESS interest (subsection 83A-10(1)).

49. The Plan is an employee share scheme as defined in subsection 83A-10(2), as it is a scheme under which ESS interests in AUL are provided to employees, or associates of employees, of AUL, or a subsidiary of the AUL, in relation to the employee's employment (subsection 83A-10(2)).

Indeterminate right

50. Subsection 83A-340(1) applies where you acquire a beneficial interest in a right that later becomes a right to acquire a beneficial interest in a share, which is referred to as an indeterminate right.

51. At the time the Right is acquired by you, it is not an ESS interest but an indeterminate right pursuant to section 83A-340. This is because under the Plan, the Board can choose to settle the Right in cash or by issue of an AUL MCI. In this circumstance, the Right is not a right to acquire a beneficial interest in an AUL MCI unless and until the time when the Board determines that it will not exercise their discretion to settle the Right in cash but will satisfy the Right with an AUL MCI.

52. A Right granted to you that ultimately vests and is settled with an AUL MCI is treated as if it had always been a right to acquire a beneficial interest in an AUL MCI (subsection 83A-340(2)). That is, it is treated as an ESS interest (for the purposes of subsection 83A-10(1)) from the date the Right is acquired by you.

Assessability of Rights under Subdivision 83A-B

53. As a Right is issued for no consideration, it is issued at a discount pursuant to subsection 83A-20(1). The discount is included in your assessable income in the income year you acquired the Right pursuant to subsection 83A-25(1).

54. Therefore, Subdivision 83A-B will apply to the Right acquired by you under the Plan, unless Subdivision 83A-C applies.

A mutual capital instrument is not an ordinary share

55. Subject to certain conditions being satisfied, tax concessions may be available in relation to ESS interests. These concessions are:

- an upfront concession to reduce the amount included in assessable income by up to $1,000 (section 83A-35), or
- a deferred tax concession with the amount included in assessable income deferred until a later year (Subdivision 83A-C).

56. Relevantly, one of those conditions for either section 83A-35 or Subdivision 83A-C to apply is that the ESS interests you acquire relate to ordinary shares (subsection 83A-45(2)).

57. The Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No.2) Bill 2009 (ESS EM) explains at paragraphs 1.120 and 1.121 that ESS interests must relate to ordinary shares because shares other than ordinary shares may have less risk associated with them. For example, they may pay a more stable income stream or have priority over ordinary shares in the event of winding-up.

58. Paragraphs 1.85 and 1.86 of the ESS EM explain that providing tax concessions for employees participating in employee share scheme arrangements recognises the economic benefits derived from those arrangements and that participation will help foster better working relationships and increase productivity by aligning the employee and employer interests. Similarly, paragraph 1.164 explains that the deferred tax concession is restricted to ordinary shares as ESS interests that are not ordinary shares are less likely to align the shareholder's interest with that of the company.

59. The term 'ordinary share' is not defined in the ITAA 1997. Therefore, in the context of Division 83A, the term 'ordinary share' takes its ordinary meaning. In *Norman v Norman* (1990) 19 NSWLR 314 McLelland J., when considering whether certain shares were ordinary shares, noted at [315–316]:

> The expression "ordinary shares" is [not] defined ... in the articles of association nor in the *Companies Act 1961* which was in force at the time of incorporation of the company. Counsel were unable to refer me to any authority in which the expression has been defined.
>
> In my opinion in ordinary usage the meaning of the expression "ordinary shares" is, and was in 1971, shares other than preference shares.

60. There are several cases that have considered the meaning of the term 'preference share' and in doing so have attached meaning to the term 'ordinary share'. In *Beck v Weinstock* [2013] HCA 15*,* the High Court held at [67] that a preference share is one that carries priority or preference in relation to payment of dividends, return of capital in winding-up, or voting rights or a combination of those things. It also held that ascertaining whether a share is a 'preference share' was determined by reference to the company's memorandum and articles of association, not by reference to shares on issue.

61. Therefore whether a share is an ordinary share is to be determined by considering the rights attached to the share as compared to other classes of shares in the company. Shares that have a priority as to dividends or distributions in the event of winding-up would be considered to be preference shares. If shares are not preference shares, they would be considered, by default, to be ordinary shares.

62. The *Treasury Laws Amendment (Mutual Reforms) Act 2019* made amendments to the Corporations Act to provide the mutual sector with greater certainty and confidence to be able to raise capital through a new bespoke instrument without the risk of demutualisation, which would occur if shares other than MCIs were issued.

63. In being 'a new type of bespoke share' the Explanatory Memorandum to the Treasury Laws Amendment (Mutual Reforms) Bill 2019 (MCI EM) acknowledges there is no equivalent for an MCI in the current law.[4] The MCI EM explains that while MCIs have requirements designed to be similar to preference shares, they are distinctly different to preference shares. However, the Commissioner does not consider that it automatically follows that the MCIs would be ordinary shares for the reasons outlined in paragraphs 65 to 67 of this Ruling.

64. Following the amendments to the Corporations Act, AUL amended its Constitution to allow it to issue MCIs. Consistent with the Corporations Act and its Constitution, AUL cannot issue ordinary shares while it also has AUL MCIs on issue thereby preventing them to be compared to each other.

65. Paragraph 167AF(c) of the Corporations Act requires the mutual entity's constitution to set out the rights attached to the MCI with respect to participation in surplus assets and profits. The Constitution of AUL as amended satisfies this requirement but also stipulates that this right for the holders of MCIs is a preferential right to distributions in the event of winding-up.

[4] See 'Comparison of key features of new law and current law' of Chapter 1 of the MCI EM.

66. The Constitution and each prospectus outlines the terms and conditions of AUL MCIs. Some of the features of AUL MCIs that sets them apart from being ordinary shares include:

- AUL MCI holders have priority in the distribution of surplus on winding-up compared to both shareholder members (other than MCIs) and non-shareholder members, and
- the dividends are limited to a fixed dividend rate.

67. These are not features akin to ordinary shares. Further, MCIs were not intended to be ordinary shares and AUL MCIs are a separate category of membership interest under the Constitution.

68. Therefore, AUL MCIs are not ‘ordinary shares’ for the purpose of subsection 83A-45(2).

No reduction or deferral of amount included in assessable income

69. As an AUL MCI is not an ordinary share, Subdivision 83A-C will not apply to the Right you acquired. Subdivision 83A-B will apply to the Right but you are not entitled to a reduction of amounts to be included in your assessable income pursuant to paragraph 83A-35(1)(b) and subsection 83A-45(2).

Requesting amendment to assessments

70. As the Right is an indeterminate right (as explained in paragraphs 50 to 52 of this Ruling), you will not know if you need to include the amount of the discount in your assessable income until AUL later decides whether or not to settle your Right with an AUL MCI.

71. Therefore, if AUL ultimately decides to settle your Right with an AUL MCI, you will need to request an amendment to your assessment for the income year in which you acquired the Right to include in your assessable income the amount of the discount.

72. You can request an amendment to your assessment at any time to increase your assessable income where rights are indeterminate rights pursuant to section 83A-340 (table item 28 of subsection 170(10AA) of the ITAA 1936).

Shortfall penalty and shortfall interest charge

73. Division 284 of Schedule 1 to the TAA sets out the uniform administrative penalties that apply to entities for failing to satisfy obligations under taxation laws.

74. Subsection 284-75(1) of Schedule 1 to the TAA imposes penalties for false or misleading statements according to an entity’s behaviour and actions at the time of and leading up to the making of a statement. Where the entity has taken reasonable care to comply with their tax obligations, no administrative penalty will be imposed under subsection 284-75(1) of Schedule 1 to the TAA.

75. Where your assessment of an earlier income year is amended to include an amount in relation to the Rights that vest and is settled with AUL MCIs, no shortfall penalty will be imposed as, at the time of lodgment of the original tax return, the statement made is not false or misleading.

76. Section 280-100 of Schedule 1 to the TAA imposes a shortfall interest charge (SIC) on the additional amount of tax that becomes payable as a result of a taxpayer's assessment being amended. This is to compensate the government for the impact of late payments and to ensure that taxpayers with tax shortfalls do not received an advantage over those who pay the tax properly owing at the appropriate time.

77. Section 280-160 of Schedule 1 to the TAA provides that SIC may be remitted in full or in part where it is considered to be fair and reasonable to do so.

78. Where your assessment of an earlier income year is amended to include an amount in relation to the Rights that vest and are settled with AUL MCIs, and a SIC is imposed on the additional amount of tax that becomes payable, you may request the Commissioner exercise their discretion under section 280-160 of Schedule 1 to the TAA and remit the SIC in full or in part.

Rights settled with cash

79. Division 83A will not apply where your Right is settled in cash instead of an AUL MCI.

80. Section 6-5 provides that assessable income includes income according to ordinary concepts derived during an income year. Ordinary income includes income from personal services such as employment income. Therefore, you include the cash amount you receive in your assessable income in the income year you receive it.

Dividend Equivalent Payments

Dividend Equivalent Payment delivered in mutual capital instruments

81. Subdivision 83A-B will apply where you receive a Dividend Equivalent Payment delivered in AUL MCIs.

82. The discount on the AUL MCIs is included in your assessable income in the income year you acquired it in satisfaction of the Dividend Equivalent Payment pursuant to subsection 83A-25(1).

83. As an AUL MCI is not an ordinary share, for the reasons stated in paragraphs 55 to 68 of this Ruling, you are not entitled to reduce the discount amount included in your assessable income pursuant to section 83A-35 and Subdivision 83A-C will not apply to you.

Dividend Equivalent Payment delivered in cash

84. Division 83A will not apply where you receive a Dividend Equivalent Payment delivered in cash.

85. Section 6-5 provides that assessable income includes income according to ordinary concepts derived during an income year. Ordinary income includes income from personal services such as employment income. Therefore, you include the cash amount you receive in your assessable income in the income year you receive it.

Status: **not legally binding**

References

Related Rulings/Determinations:

TD 2016/17

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 170(10AA)
- ITAA 1997 6-5
- ITAA 1997 Div 83A
- ITAA 1997 Subdiv 83A-B
- ITAA 1997 Subdiv 83A-C
- ITAA 1997 83A-10(1)
- ITAA 1997 83A-10(1)(b)
- ITAA 1997 83A-10(2)
- ITAA 1997 83A-20(1)
- ITAA 1997 83A-25(1)
- ITAA 1997 83A-35
- ITAA 1997 83A-35(1)
- ITAA 1997 83A-35(1)(b)
- ITAA 1997 83A-45
- ITAA 1997 83A-45(2)
- ITAA 1997 83A-105(1)(b)
- ITAA 1997 83A-340
- ITAA 1997 83A-340(1)
- ITAA 1997 83A-340(2)
- ITAA 1997 995-1(1)
- ITAA 1997 Div 230
- TAA 1953 Sch 1 Div 284
- TAA 1953 Sch 1 Subdiv 284-B
- TAA 1953 Sch 1 284-75(1)
- TAA 1953 Sch 1 280-100
- TAA 1953 Sch 1 280-160
- Corporations Act 2001 Part 2B.8
- Corporations Act 2001 167AF(c)

Cases relied on:

- Norman v Norman (1990) 19 NSWLR 314
- Beck v Weinstock [2013] HCA 15; 251 CLR 425; 297 ALR 21; 87 ALJR 570

Other references:

- Explanatory Memorandum to the Tax Laws Amendment (2009 Budget Measures No.2) Bill 2009
- Explanatory Memorandum to the Treasury Laws Amendment (Mutual Reforms) Bill 2019
- Treasury Laws Amendment (Mutual Reforms) Act 2019

ATO references

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