

# ***CR 2005/36 - Income tax: Agere Systems Inc. 2001 Employee Stock Purchase Plan***

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## Class Ruling

### Income tax: Agere Systems Inc. 2001 Employee Stock Purchase 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**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA 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. The tax laws dealt with in the Ruling are:
- section 139B of the *Income Tax Assessment Act 1936* (ITAA 1936); and
  - section 139CD of the ITAA 1936.

#### **Class of persons**

3. The class of persons to which this Ruling applies is Australian resident employees (the participating employees) of Agere Systems Australia Pty Ltd who participate in the Agere Systems Inc. 2001 Employee Stock Purchase Plan (the Stock Plan).

#### **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 at paragraphs 9 to 13 in this Ruling.

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

- (a) 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
- (b) this Ruling may be withdrawn or modified.

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## Date of effect

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8. This Ruling applies from the 2003/2004 income year. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, this Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later Public Ruling; or
- the relevant taxation laws are not amended.

## Arrangement

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9. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents which are attached to the file record maintained by the Australian Tax Office for this Ruling. 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 Ernst & Young dated 12 February 2004 requesting a Class Ruling on behalf of Agere Systems Inc.;

- (b) the Restated Certificate of Incorporation of Agere Systems Inc. (the Restated Certificate); and
- (c) the Agere Systems Inc. 2001 Employee Stock Purchase Plan Rules, confirmed by e-mail of 8 March 2005 as having been filed with relevant authorities in the United States.

10. Agere Systems Inc. is a United States Corporation listed on the New York Stock Exchange. Under the Stock Plan a participating employee may be entitled to Class A common stock (A stock) or Class B common stock (B stock). Both stocks are traded on the New York Stock Exchange.

11. The Restated Certificate sets out the rights and restrictions attaching to both A stock and B stock. The A stock and B stock are collectively referred to as 'common stock'. The rights and restrictions of the common stock include:

- (a) except as otherwise provided in the Articles comprising the Restated Certificate, all rights and limitations of the common stock is identical;
- (b) subject to the rights of preferred stock holders, holders of common stock are entitled to receive dividends and other distributions as declared by the Board and shall share equally on a per share basis;
- (c) at stockholder meetings, every holder of A stock is entitled to 1 vote per share held;
- (d) at stockholder meetings, every holder of B stock is entitled to 4 votes per share for the election and removal of directors and 1 vote per share on all other matters;
- (e) holders of A stock and B stock shall vote together as a single class and their votes shall be counted and totalled together on all matters submitted to a vote of stockholders, subject to any voting rights granted to holders of preferred stock; and
- (f) in the event of any dissolution, liquidation or winding up of Agere Systems Inc., after payment in full of amounts required to be paid to holders of preferred stock, the remaining assets and funds are to be distributed on a pro rata basis to the holders of the common stock and the common stock holders are entitled to receive the same amount per share.

12. The Restated Certificate also provides for the issue of preferred stock. A series of preferred stock has been created and the holders of such stock have preference to the holders of common stock and are entitled to receive quarterly dividends. Further, the holders of preferred stock rank senior to holders of common stock as to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up.

13. The participating employees in the Stock Plan are current residents of Australia, employed by Agere Systems Australia Pty Ltd, a wholly owned subsidiary of Agere Systems Inc. Agere Systems Inc. proposes to grant options under the Stock Plan to these employees to acquire shares of common stock.

## Ruling

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

14. Division 13A of Part III (Division 13A) provides for the taxation treatment of the discount, if any, given on the options to acquire common stock issued by Agere Systems Inc. under the Stock Plan. The discount will be included in assessable income of a participating employee in the year that cessation time occurs under subsection 139B(3), unless an election under section 139E is made to include the discount in the year of acquisition of the options under subsection 139B(2).

15. This tax treatment applies because the options to acquire common stock issued by Agere Systems Inc. to the participating employees under the Stock Plan 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.

## Explanation

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16. Division 13A provides for the taxation treatment of the discount given on shares or rights acquired under an employee share scheme. The discount is included in assessable income of the employee in the year that cessation time occurs under subsection 139B(3). Alternatively, if the employee makes an election under section 139E, the discount is included in assessable income in the year of acquisition of the shares or rights under subsection 139B(2).

17. The scheme of Division 13A provides for concessional taxation treatment of such shares or rights provided they satisfy certain requirements. 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.

18. Division 13A does not define what is an ordinary share. Further, the general definition provisions in subsection 6(1) of the ITAA 1936 and section 995-1 of the *Income Tax Assessment Act 1997* do not contain a definition of ordinary share. Therefore, to determine whether A stock and B stock are ordinary shares for the purposes of subsection 139CD(4) we look to other sources to determine the ordinary or common usage of that term.

19. Division 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.

20. The Explanatory Memorandum to the Taxation Laws Amendment Bill (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.

21. 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'.

22. Holders of A stock who acquire them on market have different voting rights (as described in paragraph 11) to holders of B stock who acquire them on market. However, participating employees who acquire options under the Stock Plan will have the same voting rights as other shareholders if they acquire either A or B stock as a result of exercising options under the Stock Plan. As there is no distinction between shares provided under the Stock Plan and those available to the public, the test is whether the shares in the form of the A and B stock offered to the public are ordinary shares.

23. The *Australian Oxford Dictionary* also 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.

24. 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.'

25. 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 been otherwise 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.

26. 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 (ASX) on its website in its *Glossary of Sharemarket Terms*, the definitions being current as at 23 March 2005 (last reviewed by ASX 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.

27. 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*.

28. Preferred stock in Agere Systems Inc. have preference over common stock as to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up. As such, preferred stock are considered to be preference shares in accordance with the definitional material referred to above. Common stock in Agere Systems Inc. are clearly distinguishable from preferred stock in the company and are not considered to be preference shares.

29. Common stock which are the subject of options under the Stock Plan, are also issued to members of the public and as such, participating employees in the Stock Plan will have the same voting and dividend rights as members of the public who acquire common stock in Agere Systems Inc. Thus, it is concluded that because common stock are not preference shares and because such stock issued under the Stock Plan are identical to common stock issued to the public, A and B stock in Agere Systems Inc. are ordinary shares for the purposes of Division 13A.

## **Detailed contents list**

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

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18 May 2005

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

CR 2001/1; TR 92/1; TR 92/20;  
TR 97/16; IT 2516

*Subject references:*

- employee share scheme
- ordinary shares

*Legislative references:*

- TAA 1953 Pt IVA
- ITAA 1936 6(1)
- ITAA 1936 26AAC
- ITAA 1936 26AAC(4A)
- ITAA 1936 26AAC(4A)(d)(ii)
- ITAA 1936 26AAC(4A)(d)(iii)
- ITAA 1936 26AAC(4B)
- ITAA 1936 26AAC(4C)
- ITAA 1936 26AAC(4D)
- ITAA 1936 26AAC(4E)
- ITAA 1936 26AAC(4F)
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139B
- ITAA 1936 139B(2)
- ITAA 1936 139B(3)
- ITAA 1936 139CD
- ITAA 1936 139CD(4)

- ITAA 1936 139E

- ITAA 1997 995-1

- Companies Act 1961

- Corporations Act 2001 254G

- Corporations Act 2001 254G(1)

- Corporations Act 2001 254G(2)

- Copyright Act 1968

*Case references:*

- Norman v. Norman (1990) 19  
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