


CR 2007/6 - Income tax: demerger of NuSep Limited by Life Therapeutics Limited

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Class Ruling

Income tax: demerger of NuSep Limited by Life Therapeutics Limited

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936; and
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Life Therapeutics Limited (LT) who:

- (a) participated in the scheme that is the subject of this Ruling;

- (b) owned ordinary shares in LT and held those shares on capital account at the time the scheme was undertaken; and
- (c) were residents of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time the scheme was undertaken.

4. In this Ruling this class of entities is referred to as the 'participating LT shareholders'.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 31 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

10. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

14. This description is based on a number of documents provided to the Commissioner. 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 include:

- Class Ruling Application dated 8 September 2006 from Ernst & Young; and
- correspondence from Ernst & Young providing further information on various dates between 10 October 2006 and 18 December 2006.

Note: where certain information received from Ernst & Young was provided on a commercial-in-confidence basis, it will not be disclosed or released under the Freedom of Information legislation.

Background

15. The scheme that is the subject of this Ruling involved the transfer by LT of ownership of its Life Gels and Laboratory Gradiflow businesses to its shareholders. This was effected by LT placing those businesses in a new subsidiary called NuSep Ltd (NuSep) and then transferring the shares in NuSep to the LT shareholders as a capital return.

16. The restructure has happened and was effective from 7 December 2006.

The LT Group

17. LT is the head of a biotechnology group that specialises in the manufacture of plasma derived products. LT is an Australian resident company and is listed on the Australian Stock Exchange (ASX). It has approximately 98.67 million ordinary shares on issue.

18. LT also has other instruments on issue:

- convertible notes;
- a convertible loan issued to a third party; and
- employee options over LT shares.

19. LT is the head company of a tax consolidated group.

NuSep and the Life Gels and Gradiflow businesses

20. The LT group undertook a number of transactions to separate the Life Gels and Gradiflow businesses, as follows:

- LT incorporated NuSep as a wholly-owned subsidiary on 11 July 2006. NuSep was incorporated in Victoria. LT held the one ordinary share on issue in NuSep;
- LT transferred the Life Gels and Gradiflow business assets and liabilities to NuSep;
- consideration for the transfer of these assets and liabilities was \$3.5 million, satisfied by the issue by NuSep of ordinary shares to LT. The consideration paid was based on an estimate of the market value of these businesses provided by valuer, Innovation Dynamics; and
- NuSep has appointed a separate management team.

21. The business of NuSep is to sell pre-cast gels for use in biological and diagnostic testing.

Distribution of NuSep shares to the LT shareholders

22. LT distributed all of the 4,934,592 shares it owned in NuSep to its shareholders. LT effected this by:

- returning a total of \$3.58 million of share capital to the LT shareholders (or approximately \$0.036 per share); and
- satisfying this share capital return by the *in specie* distribution of NuSep shares. LT shareholders received 1 NuSep share for every 20 LT shares they owned at Record Date (which was 7 December 2006).

23. The return of capital (distribution of the NuSep shares) happened on 7 December 2006, which was also the Record Date for determining entitlements.

24. LT recorded the distribution in its accounts as follows:

Dr	Share capital	\$3,580,000
Cr	Investment in NuSep	\$3,580,000

25. LT shareholders that are not Australian residents participated in the share capital return and transfer of the NuSep shares on the same basis as other LT shareholders. However the non-residents who held their LT shares through an ADR deposit agreement, had their NuSep shares, which were provided in satisfaction of the share capital return, transferred to a nominee. The nominee sold these NuSep shares and remitted the proceeds to each of the non-resident shareholders.

Reason for the restructure and distribution

26. The separation of NuSep from the LT group was undertaken for a number of reasons which may be summarised as follows:

- to comply with a covenant attaching to the convertible notes LT has on issue;
- to create two separate viable businesses who will separately pursue different strategic, operational and investment objectives;
- NuSep is not integral to LT's long term business plan, and its disposal will simplify LT's business operations;
- enable NuSep to enter alliances with other companies operating in the same field; and
- shareholders are provided with greater choice and flexibility to choose to invest in one or both of the businesses.

Other matters

27. Following the distribution of the NuSep shares, NuSep will raise additional capital and proceed to apply for listing on the ASX.

28. LT confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts.

29. LT has never recorded an accounting profit in its books of account and has consequently never paid a dividend to its shareholders. Also, LT has never returned share capital or share premium, or issued bonus shares to its shareholders.

30. All LT shareholders acquired their LT shares on or after 20 September 1985.

31. This scheme is not a Demerger as described in Division 125 of the ITAA 1997, and demerger rollover is not available to LT shareholders.

Ruling

32. The return of capital of approximately \$0.036 per LT share under the scheme is not a 'dividend' as defined by subsection 6(1) of the ITAA 1936.

Anti-avoidance provision – section 45B

33. The Commissioner will not make a determination under section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the return of capital received by the participating LT shareholders.

Capital gains tax (CGT) consequences

34. CGT event G1 happened to the participating LT shareholder when the return of capital was paid (section 104-135 of the ITAA 1997).

Commissioner of Taxation

31 January 2007

Appendix 1 – Explanation

❶ *This Appendix 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.*

Dividends

35. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends, as defined in subsection 6(1) of the ITAA 1936, paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a foreign resident).

36. The word 'dividend' in subsection 6(1) of the ITAA 1936 includes any distribution made by a company to any of its shareholders. However, paragraphs (d) to (f) of the definition exclude certain items from being a dividend for income tax purposes.

37. Relevantly, paragraph (d) of the definition of 'dividend' specifically excludes:

money paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection 6(4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

38. A 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

39. Subsection 975-300(3) of the ITAA 1997 provides that an account is not a 'share capital account' if it is tainted. Section 197-50 of the ITAA 1997 describes a share capital account as being tainted if an amount, to which Division 197 of the ITAA 1997 applies, is transferred to the account and the account is not already tainted.

40. The return of capital in the scheme to which this Ruling relates was debited against LT's share capital account. Further, LT has confirmed there have been no transfers to this account that would result in it becoming tainted. Therefore paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies and the return of capital does not constitute a dividend. The return of capital will not be assessable income under subsection 44(1) of the ITAA 1936.

Anti-avoidance provision – section 45B

41. Section 45B of the ITAA 1936 is an anti-avoidance provision which allows the Commissioner to determine that all or part of a capital benefit is treated as an unfranked dividend that is paid by the company out of profits to the shareholder. The section broadly applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

42. Subsection 45B(2) of the ITAA 1936 sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) that section 45C of the ITAA 1936 applies. These conditions are that:

- there is a scheme under which a person is provided with a capital benefit by a company;
- under the scheme a person (the relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit; and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into or carried out the scheme or any part of the scheme for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

43. Each of these conditions is considered below.

Scheme

44. The return of capital is a 'scheme' within the broad meaning of that term.

Capital benefit

45. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. Relevantly, it includes both the provision of ownership interests in a company to a person and a distribution to a person of share capital.

46. As LT debited the return of capital against its share capital account, and satisfied this capital return by the in specie distribution of the NuSep shares, its shareholders will be provided with a capital benefit.

Tax benefit

47. A shareholder 'obtains' a 'tax benefit', as defined in subsection 45B(9) of the ITAA 1936, where:

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997,

by the taxpayer would, apart from the operation of section 45B of the ITAA 1936:

- be less than the amount that would have been payable; or
- be payable at a later time than it would have been payable,

if the capital benefit had instead been a dividend.

48. In the present circumstances, most LT shareholders will obtain a tax benefit. This is because any capital gain made as a result of a return of share capital is calculated only after taking into account the cost base of the relevant shares or other asset. Further, any resulting capital gain may be subject to concessional tax treatment (for example, 50% CGT discount). In these circumstances, the tax payable will therefore be less than if the whole share capital amount were assessed as a dividend.

Purpose of obtaining a tax benefit

49. The objective conclusion as to the requisite purpose is made having regard to the relevant circumstances of the scheme, including those set out in subsection 45B(8) of the ITAA 1936.

50. Paragraph 45B(8)(a) of the ITAA 1936 refers to the extent to which the capital benefit is attributable to capital or profits (realised and unrealised) of the company or an associate (within the meaning of section 318 of the ITAA 1936) of the company. In the present circumstances, it is accepted that the return of share capital is referable to share capital contributed by LT shareholders. It is clear that the acquisition of the assets that constitute the NuSep company has been wholly from share capital. This is reinforced by the fact that LT has significant accumulated losses in its balance sheet and has never made accounting profits.

51. Paragraph 45B(8)(b) of the ITAA 1936 refers to the pattern of distributions made by a company or an associate of the company. LT has never made a distribution of a profit, share capital, or share premium. Neither has it issued bonus shares. The present distribution cannot be said to be in any way a substitute for any distribution pattern of LT, nor as an extraordinary payment as a substitute for the absence of such distributions.

52. Paragraphs 45B(8)(c) to (i) of the ITAA 1936 largely relate to the tax and other circumstances of the shareholders. These paragraphs do for example, look to the cost base and pre-CGT and post-CGT status of the relevant shares, as well as to matters such as whether the scheme is also for the on-sale of the shares in those cases (as the present one) where shares are distributed. In the present circumstances, there is nothing known of the characteristics of the LT shareholders (and their LT shares) to indicate that the return of capital was made with a purpose of providing a tax benefit. These circumstances incline neither for nor against the relevant purpose.

53. Paragraph 45B(8)(k) of the ITAA 1936 refers to the matters in subparagraphs 177D(b)(i) to (viii) of the ITAA 1936. These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, its form and substance, and its financial and other implications for the parties involved. In the present case, the practical implications of the scheme for LT and its shareholders are consistent with its being, in form and in substance, a distribution of share capital. Further, since it also involves the distribution of shares in a subsidiary, NuSep, it is relevant to consider the commercial and other objects of this event. Those objects are to facilitate the splitting of two distinct businesses, allowing them to pursue separate business strategies and allowing shareholders the clear choice of which to invest in.

54. Having regard to all the relevant circumstances of this scheme, the Commissioner would not therefore come to the objective conclusion that a non-incidental purpose of providing the capital benefit to the LT shareholders is to obtain a tax benefit. The Commissioner would not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies.

Capital gains tax consequences

CGT event G1: section 104-135

55. CGT event G1 (section 104-135 of the ITAA 1997) happens if a company makes a payment to a shareholder in respect of a share they own in the company and some or all of the payment (non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47 of the ITAA 1936. The payment can include giving property (section 103-5 of the ITAA 1997).

56. CGT event G1 happened to the participating LT shareholders who held LT shares at the time when the NuSep shares were distributed (that is, when the payment was made).

57. As a result of CGT event G1 happening, the cost base and reduced cost base of each LT share is reduced (but not below nil) by the non-assessable part, in this case being the amount of the return of capital (subsections 104-135(3) and (4) of the ITAA 1997).

58. A participating LT shareholder made a capital gain if the return of capital by the company in relation to each LT share exceeded the cost base of the share (subsection 104-135(3) of the ITAA 1997). If the LT share was acquired by the shareholder at least 12 months before the date of payment, a capital gain from the share may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Appendix 2 – Detailed contents list

59. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital gains
- capital gains tax
- CGT assets
- CGT cost base
- CGT discount
- CGT events
- CGT events G1-G3 - shares
- CGT reduced cost base
- demerger
- return of capital on shares
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- ITAA 1936 45B(8)(e)
- ITAA 1936 45B(8)(f)
- ITAA 1936 45B(8)(g)
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- ITAA 1936 45B(8)(i)
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- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
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- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)

Legislative references:

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- ITAA 1936 6(1)(d)
- ITAA 1936 6(1)(e)
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- ITAA 1936 44(1)
- ITAA 1936 45B
- ITAA 1936 45B(2)
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ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to
G3 - shares