


# ***CR 2009/34 - Income tax: demutualisation of Australian Health Management Group Pty Limited***

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## Class Ruling

# Income tax: demutualisation of Australian Health Management Group Pty 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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

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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:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-25 of the ITAA 1997; and
- Division 315 of the ITAA 1997.

All legislative references are to the ITAA 1997 unless otherwise indicated.

## Class of entities

3. The class of entities to which this Ruling applies is the members of Australian Health Management Group Pty Limited (AHM) who:

- were members of AHM on 13 July 2008 (the Cut-Off Date);
- remained members of AHM at 10:30 am (AEDT) on 6 December 2008 (the Record Time); and
- participated in the scheme of arrangement as described in paragraphs 9 to 17 of this Ruling.

In this Ruling, the persons belonging to this class of entities are referred to as 'Participating AHM Members'.

## Qualifications

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

5. 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 9 to 17 of this Ruling.

6. 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

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8. This Ruling applies from 1 July 2008 to 30 June 2010. The Ruling continues to apply after 30 June 2010 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

## Scheme

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9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- the Class Ruling application dated 21 January 2009;
- Information Memorandum – Demutualisation and Merger Proposal dated 3 October 2008; and
- correspondence from Ernst & Young dated 26 March 2009.

**Note:** certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

10. The scheme that is the subject of this Ruling involves the demutualisation of AHM (the AHM demutualisation), which was undertaken in conjunction with the acquisition by Medibank Private Limited (Medibank) of 100% of the ownership interests in AHM. Under the AHM demutualisation, Participating AHM Members are entitled to a cash payment or payments in consideration for the cancellation of their membership interests in AHM.

## Background

11. AHM, prior to its demutualisation, was a company limited by guarantee that was registered to provide health insurance under the *Private Health Insurance Act 2007* (PHIA) as a not-for-profit insurer. AHM was not registered under the *Life Insurance Act 1995* and had 161,636 members at the Cut-Off Date.

12. Medibank and AHM entered into a Merger Implementation Deed (MID) dated 14 July 2008, which was amended and restated on 15 September 2008. The parties agreed that Medibank will acquire AHM.

13. Over the period 14 October 2008 to 28 October 2008 AHM provided its members with the AHM Information Memorandum describing both the demutualisation and the merger proposals. In summary the AHM Information Memorandum provided that:

- AHM's Constitution would be amended to permit Medibank to become a member of AHM;
- AHM would convert from a public company limited by guarantee to a proprietary company limited by shares; and
- all of AHM membership interests (other than those held by Medibank) would be cancelled and, in consideration for the cancellation, the amount of \$367 million (the Merger Consideration) would be paid in accordance with the Allocation Rules described in Schedule 5 of the Information Memorandum.

14. The demutualisation and merger were carried out by means of the following steps:

- (a) on 3 December 2008, the Private Health Insurance Administration Council approved AHM's application to convert its registration to a for-profit insurer within the meaning of the PHIA;
- (b) on 8 December 2008, AHM members approved both the demutualisation scheme resolution and the merger resolutions;
- (c) on 10 December 2008, the Federal Court of Australia made orders approving the scheme of arrangement. Following the Federal Court's approval, Medibank became a member of AHM;
- (d) on 14 January 2009, all AHM memberships (other than Medibank) were cancelled and the liability of each member (other than Medibank) as a guarantor on a winding up of AHM was extinguished;
- (e) on 15 January 2009, AHM changed from a public company limited by guarantee to a proprietary company limited by shares. Medibank was issued with AHM shares to the value of \$367 million;
- (f) on 16 January 2009, AHM was registered as a for-profit health insurer under the PHIA; and
- (g) commencing 16 January 2009 the Merger Consideration was paid to Participating AHM Members.

**Payment of the Merger Consideration**

15. The Merger Consideration was paid to Participating AHM members in stages. Approximately 98.6% of the Merger Consideration was paid to Participating AHM Members over the period 16 January to 29 January 2009. The remainder was set aside for the review process.

16. Applicants could apply for the Review Committee to determine the correct allocation of their entitlement, or whether the applicant should have been treated as a Participating AHM Member under the AHM demutualisation.

17. Thus, the final amount paid for the cancellation of the membership interest of each Participating AHM Member will not be determined until after the review process is completed (being 10 business days after 30 June 2009).

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**Ruling****Capital gains tax**

18. CGT event C2 happened when the Participating AHM Member's membership interests in AHM were cancelled (subsection 104-25(1)). The time of the event was 14 January 2009, the implementation time for the AHM demutualisation (subsection 104-25(2)).

**Division 315**

19. The demutualisation of AHM is a demutualisation to which Division 315 of Part 3-32 applies.

20. Participating AHM Members disregard any capital gain or capital loss made from CGT event C2 happening in relation to their membership interests (section 315-5).

21. The amount received by a Participating AHM Member under the demutualisation is not considered to be ordinary income under section 6-5 or statutory income, but to the extent (if any) that it is ordinary income or statutory income, it is neither assessable nor exempt income (section 315-310).

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**Commissioner of Taxation**8 July 2009

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## Appendix 1 – Explanation

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**ⓘ** *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.*

### Capital Gains Tax

#### **CGT event C2**

22. CGT event C2 happens if, among other things, the ownership of an intangible CGT asset ends by the asset being redeemed, cancelled, released, discharged or expiring (subsection 104-25(1)).

23. CGT event C2 happened in relation to each membership interest (an intangible CGT asset) when the Participating AHM Member's membership interest was cancelled under the AHM demutualisation.

24. A Participating AHM Member made a capital gain if the capital proceeds from the ending of their membership interest are more than its cost base. A Participating AHM Member made a capital loss if the capital proceeds are less than the membership interest's reduced cost base.

25. The capital proceeds for the cancellation of each membership interest is the cash received by the Participating AHM Member under the AHM demutualisation including any amounts received after the review process is completed.

### Division 315

26. Division 315 sets out the taxation consequences resulting from the demutualisation of private health insurers if certain conditions are satisfied.

#### **Does Division 315 apply?**

27. Division 315 applies to a demutualisation of an entity if the conditions set out in section 315-15 are satisfied. The AHM demutualisation satisfies these conditions because:

- (a) AHM was, prior to its demutualisation, an entity to which item 6.3 of the table in section 50-30 applies (that is, it was a private health insurer within the meaning of the PHIA that was not carried on for the profit or gain of its individual members);
- (b) at no time has AHM been registered under the *Life Insurance Act 1995*;
- (c) AHM was not, prior to its demutualisation, a company limited by shares;

- (d) AHM obtained approval under subsection 126-42(5) of the PHIA for its application to convert to a 'for-profit insurer' (the conversion scheme); and
- (e) consistently with the conversion scheme, AHM became registered as a for-profit insurer.

### ***CGT consequences***

28. Section 315-5 provides that an individual shall disregard a capital gain or capital loss made from a CGT event that happens in relation to a CGT asset if the following three conditions are satisfied:

- (a) the CGT event happens under a demutualisation to which Division 315 applies;
- (b) the individual is, or has been, a policy holder of, or another person insured through, the demutualising entity; and
- (c) the CGT asset is covered by section 315-20.

### ***CGT event under a demutualisation***

29. Relevantly, as the Participating AHM Member's membership interest was cancelled under the AHM demutualisation, CGT event C2 happened 'under a demutualisation' to which Division 315 applies.

### ***Policy holder or another person insured***

30. The PHIA defines a 'policy holder of a health benefits fund' as a 'holder' of a policy that is referable to that fund.

31. Each Participating AHM Member was a 'member' of AHM under its constitution. Further, as a condition of being a member, each Participating AHM Member also held a policy of private health insurance with AHM.

32. Accordingly, each Participating AHM Member was a policy holder of the demutualising entity thereby satisfying the condition in paragraph 315-5(b).

### ***CGT asset of a type covered by section 315-20***

33. The term 'CGT asset' is defined in section 108-5 as any kind of property, or a legal or equitable right that is not property.

34. Section 315-20 covers four categories of CGT assets:

- (a) an interest in the demutualising health insurer as a policy holder;
- (b) a membership interest in the demutualising health insurer;

- (c) a right or interest of another kind in the demutualising health insurer; and
- (d) a right or interest of another kind that arises under the demutualisation.

35. The Participating AHM Member's membership interest in AHM is a CGT asset covered by paragraph 315-20(b).

### ***Effect of the application of Division 315***

36. Accordingly, as CGT event C2 happened under the demutualisation of AHM, the Participating AHM Members disregard any capital gain or capital loss made when their membership interests in AHM were cancelled under the AHM demutualisation (section 315-5).

### ***Ordinary or statutory income***

37. Subsection 315-310(1) relevantly provides that an amount that would otherwise be included in the assessable income of an entity as ordinary income or statutory income because of a demutualisation will be neither assessable nor exempt income of the entity if it is:

- paid to the entity under a demutualisation to which Division 315 applies; and
- paid in connection with the cancellation of a CGT asset covered by section 315-20.

38. Whilst the amount paid to a Participating AHM Member under the demutualisation is not considered to be either ordinary income under section 6-5 or statutory income, to the extent (if any) that it is ordinary income or statutory income it will be excluded from assessable income and exempt income by subsection 315-310(1) as:

- the amount is paid under a demutualisation to which Division 315 applies;
- it is paid in connection with the cancellation of a CGT asset covered by section 315-20; and
- a Participating AHM Member is an entity to which subsection 315-310(2) applies.

## **Appendix 2 – Detailed contents list**

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

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## References

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- Previous draft:*
- ITAA 1997 6-5
- Not previously issued as a draft
- ITAA 1997 50-30
  - ITAA 1997 104-25
- Related Rulings/Determinations:*
- ITAA 1997 104-25(1)
  - ITAA 1997 104-25(2)
- TR 2006/10
- ITAA 1997 108-5
- Subject references:*
- capital gains tax
    - ITAA 1997 Div 315
    - ITAA 1997 315-5
  - CGT demutualisation
    - ITAA 1997 315-5(b)
  - CGT events
    - ITAA 1997 315-15
  - CGT events C1-C3 – end of a CGT asset
    - ITAA 1997 315-20
    - ITAA 1997 315-20(b)
  - income
    - ITAA 1997 315-310
  - non-assessable non-exempt income
    - ITAA 1997 315-310(1)
    - ITAA 1997 315-310(2)
  - private health funds
    - PHIA 2007 126-42(5)
    - Life Insurance Act 1995
    - TAA 1953
- Legislative references:*
- Copyright Act 1968
  - ITAA 1997
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### ATO references

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