


CR 2012/90 - Income tax: demerger of Audeo Oncology, Inc by Alchemia Limited

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Class Ruling

Income tax: demerger of Audeo Oncology, Inc by Alchemia 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

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

Relevant provisions

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45BA of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- subsection 109-5(2) of the ITAA 1997;
- section 115-30 of the ITAA 1997; and
- Division 125 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies comprises the shareholders of Alchemia Limited (Alchemia) who:

- are listed on the share register of Alchemia as at the Record Date;
- hold their Alchemia shares on capital account on the Record Date;
- are a 'resident of Australia' as defined in subsection 6(1) of the ITAA 1936; and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Alchemia shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, a person belonging to this class of entities is referred to as an 'Alchemia shareholder'.

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 33 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

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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

9. The following description of the scheme is based on information provided by the applicant.

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

Background

10. On 7 November 2011 Alchemia announced to the Australian Securities Exchange (ASX) that it intended to restructure into two companies.

11. At the date of the announcement, Alchemia's core assets were split between itself and its wholly owned subsidiary, Alchemia Oncology Pty Ltd (Alchemia Oncology).

12. To facilitate the demerger a new company Audeo Oncology Inc (Audeo Oncology) was established to allow the oncology business to be listed on the American Securities Exchange NASDAQ.

Relevant entities

Alchemia Limited

13. Alchemia is an Australian resident biotechnology company listed on the ASX.

14. Alchemia is engaged in the research and development of human therapeutics based on its proprietary drug discovery, drug targeting and synthesis technologies.

15. Alchemia has three main focus areas:

- commercialisation of 'Generic fondaparinux', which was approved by the U.S. Food and Drug Administration in July 2011 and is currently being distributed in the United States by Alchemia's manufacturing and marketing partner;
- development of Hyaluronic Acid Chemotransport Technology (HyACT®) a drug targeting platform designed to improve the effectiveness of anti-cancer drugs; and
- evaluation of a drug discovery platform known as VAST (Versatile Assembly on Stable Templates).

16. As at 27 August 2012 Alchemia had 280,617,079 shares on issue. It also had 3,463,000 unlisted options on issue.

17. The outstanding options were issued under an Employee and Officers Option Plan operated by Alchemia, and will be retained by their current holders, even if they cease to be employed by the Alchemia Group as a result of the demerger. The exercise price of the outstanding Alchemia options will be reduced by an amount which is equivalent to the value of the Demerger Entitlement.

18. The outstanding options issued under the Employee and Officers Option Plan represent less than 3% of the ownership interests in Alchemia (taking into account both their number and value).

Audeo Oncology

19. Audeo Oncology was incorporated in Delaware, USA.

20. As at 27 August 2012 Alchemia held 100% of the 7,500,020 issued shares of Audeo Oncology.

21. Audeo Oncology, through its subsidiary, Alchemia Oncology owns the HyACT® platform.

22. Audeo Oncology, through its subsidiary Audeo Discovery Pty Ltd licenses the VAST intellectual property from Alchemia.

The demerger of Audeo Oncology

23. The demerger will occur after Alchemia shareholders approve the capital reduction to be satisfied by an *in specie* distribution to the shareholders of Alchemia of 100% of the shares in Audeo Oncology held by Alchemia.

24. Alchemia shareholders will receive either

- one Audeo Oncology share; or

- one Audeo Oncology Chess Depository Interest (Audeo Oncology CDI).

for every thirty seven shares held in Alchemia.

25. Each Alchemia shareholder can elect to receive Audeo Oncology shares rather than Audeo Oncology CDIs under the Scheme. If no election is made the Alchemia shareholder will receive Audeo Oncology CDIs.

26. The demerger of Audeo Oncology from Alchemia will be effected by a reduction in the share capital of Alchemia and by payment of a demerger dividend that will be satisfied by an *in specie* distribution of 100% of the shares in Audeo Oncology held by Alchemia to Alchemia shareholders.

27. Alchemia will account for the demerger as follows:

DR Share Capital	\$54,442,340
CR Investment in Audeo Oncology	\$54,442,340

Reasons for the demerger

28. Alchemia considers the main advantages from the demerger to be:

- Alchemia shareholders will retain an interest in the development of the oncology assets through their individual pro-rata shareholdings in Audeo Oncology;
- to provide investors with a clear choice between the oncology business and the Generic fondaparinux business which each have markedly different risk and return profiles;
- to allow Alchemia to rationalise its cost structure whilst effectively managing its ongoing relationship with its manufacturing and marketing partner; and
- to allow the better management of the respective risks of the two arms of the Alchemia business – one cash generative and one concerned with drug development.

Other matters

29. Alchemia 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 and accordingly its share capital account is not tainted (within the meaning of Division 197 of the ITAA 1997).

30. Alchemia confirms that capital gains tax (CGT) assets representing more than 50% of the market value of all the CGT assets of Audeo Oncology and its subsidiaries will be used directly or indirectly in a business carried on by Audeo Oncology or its subsidiaries just after the demerger.

- 31. Alchemia has never paid a dividend to its shareholders.
- 32. Alchemia confirms that it will not make an election under subsection 44(2) of the ITAA 1936.
- 33. None of the Alchemia shareholders acquired their shares in Alchemia before 20 September 1985.

Ruling

CGT consequences

CGT event G1

- 34. CGT event G1 happens in relation to each Alchemia share owned by an Alchemia shareholder at the time Alchemia makes the payment of the capital reduction amount (section 104-135 of the ITAA 1997).
- 35. An Alchemia shareholder will make a capital gain when CGT event G1 happens if the market value of the capital reduction amount received for each Alchemia share exceeds the cost base of that share. The capital gain is equal to the amount of the excess (subsection 104-135(3) of the ITAA 1997). No capital loss can be made when CGT event G1 happens.

Demerger roll-over relief

- 36. Alchemia and its subsidiary Audeo Oncology are part of a demerger group under subsection 125-65(1) of the ITAA 1997.
- 37. A demerger, as described under section 125-70 of the ITAA 1997, happens to the Alchemia demerger group under the scheme.
- 38. An Alchemia shareholder can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing roll-over

- 39. An Alchemia shareholder who chooses demerger roll-over relief can disregard any capital gain made when CGT event G1 happens to their Alchemia shares under the demerger (subsection 125-80(1) of the ITAA 1997).

Other CGT consequences of choosing roll-over

- 40. If an Alchemia shareholder chooses roll-over relief, they must also recalculate the cost base and reduced cost base of their Alchemia and Audeo Oncology shares.

41. The first element of the cost base and reduced cost base of each Alchemia share and corresponding Audeo Oncology share received under the demerger is worked out as follows:

- sum the cost base of each Alchemia share (just before the demerger); and
- apportion that sum over the Alchemia shares and corresponding new Audeo Oncology shares received under the demerger on a reasonable basis, having regard to the market values (just after the demerger) of the Alchemia and Audeo Oncology shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

Alchemia shareholders who do not choose roll-over

42. Alchemia shareholders who do not choose demerger roll-over relief:

- are not entitled to disregard any capital gain made when CGT event G1 happens to their Alchemia shares under the demerger; and
- the first element of the cost base and reduced cost base of each Alchemia share and the corresponding Audeo Oncology share is calculated in the same manner as if they had chosen demerger roll-over (see paragraph 41 of this Ruling (subsection 125-85(1) and 125-85(2) of the ITAA 1997)).

Acquisition date of the Audeo Oncology shares

43. For the purpose of determining eligibility for a discount capital gain, the Audeo Oncology shares received by an Alchemia shareholder will be taken to have been acquired on the date the shareholder acquires, for CGT purposes, the corresponding Alchemia shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case whether demerger roll-over relief is chosen or not.

44. For all other CGT purposes, Alchemia shareholders acquire their Audeo Oncology shares on the date that the Audeo Oncology shares are transferred to them by Alchemia, being the Demerger Implementation Date (subsection 109-5(2) of the ITAA 1997).

Dividend consequences

45. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).

46. The demerger dividend is neither assessable income nor exempt income of the Alchemia shareholders (subsections 44(3) and 44(4) of the ITAA 1936).

47. As the capital reduction amount will be debited to Alchemia's share capital account it will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

Application of section 45B, 45BA and 45C of the ITAA 1936

48. The Commissioner will not make a determination under paragraph 45B(3)(a) of the ITAA 1936 that section 45BA of the ITAA 1936 applies to the whole or any part of any demerger benefit provided to Alchemia shareholders under the demerger.

49. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the capital benefit provided to participating Alchemia shareholders under the demerger.

Commissioner of Taxation

17 October 2012

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.*

CGT consequences

50. A significant consequence of the scheme is the availability of demerger roll-over under Division 125 of the ITAA 1997. Broadly, Alchemia shareholders can choose roll-over to disregard a capital gain made under the demerger. There are special rules for calculating the cost base and reduced cost base of the Alchemia and Audeo Oncology shares for Alchemia shareholders whether or not they choose roll-over.

Conditions for demerger roll-over relief

51. Subsection 125-55(1) of the ITAA 1997 provides that roll-over may be chosen if, at the time of the scheme:

- a shareholder owns a share in a company – this requirement is satisfied as participating shareholders own shares in Alchemia;
- the company is the head entity of a demerger group – this requirement is satisfied as Alchemia is the head company of a demerger group (see paragraphs 13 to 18 of this Ruling);
- a demerger happens to the demerger group – this requirement will be satisfied as a demerger will happen to the Alchemia demerger group (see paragraph 23 of this Ruling); and
- under the demerger a CGT event happens to the original interest and a new or replacement interest will be acquired in the demerged entity – this requirement will be satisfied because CGT event G1 happens to the Alchemia shares (see paragraphs 34 to 35 of this Ruling) and Alchemia shareholders receive Audeo Oncology shares under the demerger.

52. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied. Therefore, Alchemia shareholders can choose roll-over relief for the demerger.

Demerger Dividend

53. Subsection 44(1) of the ITAA 1936 operates to include in a shareholder's assessable income any dividend, within the meaning of that term in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

54. Paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 provides that a dividend excludes amounts debited against an amount standing to the credit of the share capital account of the company.

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

56. However, subsection 975-300(3) of the ITAA 1997 provides that an account is not a share capital account if it is tainted. A share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the share capital account where the account is not already tainted.

57. In the circumstances of this demerger, Alchemia will debit a capital reduction amount to its 'share capital account' as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997. This amount is therefore not a dividend for the purposes of subsection 6(1) of the ITAA 1936 and is not assessable as a dividend under subsection 44(1) of the ITAA 1936.

58. However, Alchemia shareholders will receive a dividend to the extent that the market value of the Audeo Oncology shares distributed under the demerger exceeds the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

59. This dividend is neither assessable income nor exempt income (subsections 44(3) and 44(4) of the ITAA 1936) if:

- the dividend is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936);
- the head entity did not elect that subsections 44(3) and 44(4) of the ITAA 1936 do not apply to the demerger dividend (subsection 44(2) of the ITAA 1936); and
- subsection 44(5) of the ITAA 1936 is satisfied.

60. In the present circumstances, each of the conditions in paragraph 59 of this Ruling will be satisfied. Therefore, any dividend received by Alchemia shareholders under the demerger is neither assessable income nor exempt income by operation of subsections 44(3) and 44(4) of the ITAA 1936.

The application of sections 45B, 45BA and 45C of the ITAA 1936

61. Section 45B of the ITAA 1936 applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

- (a) components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger; or
- (b) certain payments, allocations and distributions are made in substitution for dividends.

62. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met, the requisite purpose of enabling the Alchemia shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

63. Accordingly, the Commissioner will not make a determination under paragraphs 45B(3)(b) of the ITAA 1936 that either sections 45BA or 45C of the ITAA 1936 apply to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 109-5(2)
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-65(1)
 - ITAA 1997 125-70
 - ITAA 1997 125-80(1)
 - ITAA 1997 125-80(2)
 - ITAA 1997 125-80(3)
 - ITAA 1997 125-85(1)
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 - ITAA 1997 Div 197
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 - ITAA 1997 975-300
 - ITAA 1997 975-300(3)
 - TAA 1953
 - Copyright Act 1968
 - ITAA 1936 6(1)
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 - ITAA 1936 44(4)
 - ITAA 1936 44(5)
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ATO references

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Income Tax ~~ Capital Gains Tax ~~ demerger relief

Income Tax ~~ Return of capital