

CR 2015/100 - Income tax: EcoBiotics Limited - demerger of QBiotics Limited



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Class Ruling

Income tax: EcoBiotics Limited – demerger of QBiotics 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 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 44 of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A 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 115-30(1) of the ITAA 1997, and

- Division 125 of the ITAA 1997.

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

Class of entities

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

- were registered on the share register on the Record Date (19 November 2015)
- hold their EcoBiotics shares on capital account¹ on the Record Date
- are a 'resident of Australia',² and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their EcoBiotics shares.

(Note: Division 230 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 'EcoBiotics 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 8 to 23 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.

¹ That is, they are neither held as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1)).

² As defined in subsection 6(1) of the ITAA 1936.

Date of effect

7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

8. The following description of the scheme is based on information provided by EcoBiotics.

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

9. The scheme that is the subject of this Ruling involves the demerger of QBiotics Limited (QBiotics) by EcoBiotics to be implemented within 15 Business Days after the passing of the Resolution at the Annual General Meeting.

EcoBiotics and QBiotics

10. EcoBiotics is an Australian resident unlisted public company formed in 2000 and is in the business of early stage development of new bioactive compounds.

11. EcoBiotics, via its knowledge-based discovery platform EcoLogic, was successful in the discovery of anticancer drug EBC-46 and the wound healing treatment WH-1.

12. To undertake later stage development of EBC-46, EcoBiotics established QBiotics in 2004 by providing initial seed funding and services. At the time, EcoBiotics held 100% of QBiotics.

13. On 5 May 2010, QBiotics issued 174,999,999 shares to EcoBiotics to convert the balance in the intercompany loan account to equity. This amount represented the cumulative balance of costs incurred by EcoBiotics on behalf of QBiotics.

14. In 2010, QBiotics conducted its first capital raising to further its research and fund trials of its anti-cancer lead compound EBC-46. This capital raising resulted in QBiotics no longer being a wholly owned subsidiary of EcoBiotics.

15. As at 30 June 2015, EcoBiotics held 164,587,500 shares in QBiotics which equated to approximately 65.4% of the issued capital of QBiotics. The remaining 34.6% is owned by unrelated shareholders.

16. The ordinary shares on issue in EcoBiotics at the Record Date will be 262,441,408.

Demerger of QBiotics

17. The demerger will occur if EcoBiotics shareholders approve the resolution at the Annual General Meeting for EcoBiotics to undertake an in-specie distribution of 131,670,000 (80%) of the QBiotics shares held by EcoBiotics to EcoBiotics shareholders.

18. EcoBiotics will reduce its share capital account by \$4,126,366 (the capital reduction amount). The capital reduction amount equates to \$0.0157229 per EcoBiotics ordinary share.

19. EcoBiotics shareholders will receive QBiotics shares in the ratio of 0.501712 QBiotics shares for every EcoBiotics share held as at the Record Date.

20. EcoBiotics shareholders will not be required to pay any consideration for the QBiotics shares received by them under the demerger.

Other matters

21. EcoBiotics share capital account is not, and will not become, tainted within the meaning of Division 197.

22. Just after the demerger, at least 50% of the CGT assets of QBiotics will be used directly, or indirectly, in one or more businesses that it carries on.

23. EcoBiotics will not make an election in writing under subsection 44(2) of the ITAA 1936.

Ruling

CGT consequences

CGT event G1

24. CGT event G1 will happen at the time EcoBiotics makes the payment of the capital reduction amount (satisfied by the in specie distribution of QBiotics shares) (section 104-135).

25. An EcoBiotics shareholder will make a capital gain when CGT event G1 happens if the capital reduction amount (which equates to \$0.0157229 received for each EcoBiotics share) exceeds the cost base of that share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the EcoBiotics share is reduced to nil (subsection 104-135(3)). No capital loss can be made when CGT event G1 happens.

Demerger roll-over

26. A demerger will happen to the EcoBiotics demerger group which includes EcoBiotics and QBiotics (section 125-70).

27. Therefore, EcoBiotics shareholders can choose to obtain demerger roll-over (subsection 125-55(1) of the ITAA 1997).

Consequences of choosing demerger roll-over

28. If an EcoBiotics shareholder chooses roll-over, any capital gain made when CGT event G1 happens to their EcoBiotics shares under the demerger is disregarded (subsection 125-80(1)).

29. An EcoBiotics shareholder who chooses roll-over must also recalculate the first element of the cost base and reduced cost base of their EcoBiotics shares, and calculate the first element of the cost base and reduced cost base of the new QBiotics shares they acquire under the demerger (subsection 125-80(2)).

30. The first element of the cost base and reduced cost base of each EcoBiotics share and corresponding QBiotics share received under the demerger is worked out as follows:

- the sum of the cost bases of each EcoBiotics share just before the demerger, and
- apportioning that sum between the EcoBiotics shares and the QBiotics shares acquired under the demerger.

31. The apportionment of this sum is done on a reasonable basis having regards to the market values (just after the demerger) of the EcoBiotics and QBiotics shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)).

Consequences of not choosing demerger roll-over

32. An EcoBiotics shareholder who does not choose the roll-over:

- cannot disregard any capital gain made when CGT event G1 happens under the demerger to their EcoBiotics shares, and
- must make adjustments to the cost bases and reduced cost bases of their EcoBiotics shares and QBiotics shares in the same way as if they had chosen roll-over (subsections 125-85(1), 125-85(2) and 125-80(2)).

Acquisition date of QBiotics shares

33. For the purpose of determining eligibility to make a discount capital gain, the QBiotics shares acquired by an EcoBiotics shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding EcoBiotics shares (Item 2 in the table in subsection 115-30(1)). This will be the case whether or not the EcoBiotics shareholder chooses demerger roll-over.

Dividend consequences

34. The capital reduction amount is not a dividend as defined in subsection 6(1) of the ITAA 1936.

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

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

Anti-avoidance provisions will not apply

37. The Commissioner will not make a determination under sections 45A or 45B of the ITAA 1936 that either section 45BA of the ITAA 1936 or section 45C of the ITAA 1936 applies.

Commissioner of Taxation

25 November 2015

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

CGT event G1

38. CGT event G1 (section 104-135) happens when:

- a company makes a payment (which can include property) to a shareholder in respect of a share they own in the company
- some or all of the payment (the non-assessable part) is not a dividend or an amount that is taken to be a dividend under section 47 of the ITAA 1936, and
- the payment is not included in the shareholder's assessable income.

39. Under the demerger, EcoBiotics will make a payment to its shareholders in the form of an in-specie distribution of 131,670,000 QBiotics shares held by EcoBiotics. To the extent to which the in specie distribution is debited to the share capital account (that is, \$4,126,366), it is not a dividend and not included in the EcoBiotics' shareholders assessable income.

40. Accordingly, CGT event G1 will happen in relation to each EcoBiotics share owned by an EcoBiotics shareholder at the time EcoBiotics makes the payment of the capital reduction amount (satisfied by the in specie distribution of QBiotics shares).

41. An EcoBiotics shareholder will make a capital gain when CGT event G1 happens if the capital reduction amount (which equates to \$0.0157229 received for each EcoBiotics share) exceeds the cost base of that share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the EcoBiotics share is reduced to nil (subsection 104-135(3)). No capital loss can be made when CGT event G1 happens.

Demerger roll-over

42. The demerger roll-over provisions in Division 125 contains a number of conditions for eligibility to choose roll-over. The main conditions that are relevant to the Demerger are:

- (a) an entity owns a share in a company
- (b) the company is the head entity of a demerger group
- (c) a demerger happens to the demerger group

- (d) under the demerger, a CGT event happens to the original interest and the entity acquires a new or replacement interest in the demerged entity (which must be a company) only because they own the original interest, and acquire nothing else, and
- (e) the entity owning the original interest must acquire, under the demerger, the same proportion of new interests in the demerged entity as they owned in the head entity just before the demerger.

43. The above conditions will be satisfied in respect of the demerger of QBiotics shares. Accordingly, the demerger concessions in Division 125 will be available to EcoBiotics shareholders.

44. If an EcoBiotics shareholder chooses demerger roll-over they can disregard any capital gain made when CGT event G1 happens to their EcoBiotics shares under the demerger (subsection 125-80(1)).

45. If an EcoBiotics shareholder does not choose the roll-over, they cannot disregard any capital gain made when CGT event G1 happens under the demerger.

46. Whether or not an EcoBiotics shareholder chooses the roll-over, they must recalculate the cost base and reduced cost base of their EcoBiotics shares and calculate the cost base and reduced cost base of their new QBiotics shares in the same way (subsection 125-80(2), 125-80(3) and 125-85(2)).

47. The first element of the cost base and reduced cost base of each EcoBiotics share and corresponding QBiotics share received under the demerger is worked out as follows:

- the sum of the cost bases of each EcoBiotics share just before the demerger, and
- apportioning that sum between the EcoBiotics shares and the QBiotics shares acquired under the demerger.

48. The apportionment of this sum is done on a reasonable basis having regards to the market values (just after the demerger) of the EcoBiotics and QBiotics shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)).

Dividend consequences

49. The assessable income of a shareholder in a company includes any dividends paid to the shareholder out of profits derived by the company (subsection 44(1) of the ITAA 1936).

50. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes a distribution made by a company to any of its shareholders, whether in money or other property. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

51. EcoBiotics will debit its share capital account by \$4,126,366 which equates to \$0.0157229 per EcoBiotics share. Therefore, this amount is not a dividend and is not included in the assessable income of EcoBiotics shareholders.

52. However, EcoBiotics shareholders will receive a dividend (the demerger dividend) to the extent to which the market value of the QBiotics shares distributed under the demerger exceeds the amount of the distribution debited against the share capital account (see Taxation Ruling TR 2003/8).

53. Nevertheless, this dividend is not included in the assessable income of EcoBiotics shareholders as:

- the dividend is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936)
- it is not assessable or exempt income (subsection 44(4) of the ITAA 1936)
- EcoBiotics (as the head entity of the demerger group) does not elect for subsections 44(3) and 44(4) of the ITAA 1936 to not apply to the demerger dividend (subsection 44(2) of the ITAA 1936), and
- subsection 44(5) of the ITAA 1936 is satisfied.

Anti-avoidance provisions will not apply

54. Section 45A of the ITAA 1936 and section 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend.

Section 45A

55. Section 45A of the ITAA 1936 applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

56. As EcoBiotics will make a pro-rata return of capital to all of its shareholders in respect of their ordinary shares, there will not be streaming of capital benefits to some shareholders and not to others.

57. Accordingly, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies.

Section 45B

58. Section 45B of ITAA 1936 applies where certain payments, allocations and distributions are made to shareholders in substitution for dividends. In the event of demergers, this also applies where the components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger.

59. In broad terms, there needs to be a scheme in which, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit.

60. As the in specie distribution of QBiotics shares will generally result in a lesser amount of tax payable to EcoBiotics shareholders than what would be payable if it had instead been an assessable dividend, EcoBiotics shareholders will obtain a tax benefit within the meaning of subsection 45B(9) of the ITAA 1936.

Relevant circumstances

61. The relevant circumstances of the scheme which the Commissioner must have regard to when determining whether or not the requisite purpose exists are outlined in subsection 45B(8) of the ITAA 1936.

62. Having regard to the relevant circumstances of the scheme, it cannot be concluded that EcoBiotics will enter into or carry out the demerger for a more than incidental purpose of enabling EcoBiotics shareholders to obtain a tax benefit. The scheme appears to be carried out for genuine commercial reasons being the desire to separate the two distinctive business operations.

63. Accordingly, 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 the demerger benefit provided to EcoBiotics shareholders, or
- 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 EcoBiotics shareholders.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Legislative references:

- ITAA 1936 45B(9)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1997
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(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)
 - ITAA 1997 125-85(2)
 - ITAA 1997 Div 230
 - ITAA 1997 977-50
 - ITAA 1997 995-1(1)
 - TAA 1953
 - ITAA 1936
 - ITAA 1936 6(1)
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 - ITAA 1936 44(1)
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 - ITAA 1936 44(5)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
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 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45B(8)
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ATO references

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