


CR 2019/13 - Income tax: Invion Limited - return of capital by way of in specie distribution

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Class Ruling

Income tax: Invion Limited – return of capital by way of *in specie* distribution

Contents	Para
LEGALLY BINDING SECTION:	
Summary – what this Ruling is about	1
Date of effect	8
Scheme	9
Ruling	24
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	36
Appendix 2:	
<i>Detailed contents list</i>	69

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

This publication (excluding appendices) 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.

Summary – 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 45A of the ITAA 1936
 - section 45B of the ITAA 1936
 - section 45C of the ITAA 1936
 - section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)
 - section 104-135 of the ITAA 1997
 - section 109-5 of the ITAA 1997
 - section 112-20 of the ITAA 1997

- section 110-25 of the ITAA 1997
- subsection 115-25(1) of the ITAA 1997
- section 855-10 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936 or the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in Invion Limited (Invion) who:

- were listed on the share register of Invion on the date for determining entitlement to the *in specie* distribution, 4 February 2019, (the Record Date)
- held their shares on capital account (that is, shareholders who do not hold their Invion shares as 'revenue assets' or as 'trading stock' (as defined in section 977-50 and subsection 995-1(1)), and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their ordinary shares in Invion.

(Note: Division 230 will generally not apply to individuals, unless they have made an election for the Division to apply to them.)

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

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement 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 23 of this Ruling.

6. This Ruling does not consider the taxation consequences in relation to the Invion Executive Employee Option Plan (ESOP) or any shares issued under the ESOP since 5 September 2018.

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.

Date of effect

8. This Ruling applies from 1 July 2018 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public Rulings*).

Scheme

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

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

Background

10. Invion is an Australian resident public company which was first listed on the Australian Securities Exchange (ASX) on 15 February 2010.

11. Invion undertakes life sciences and drug development activities which are focussed on the development of clinical-stage drug assets for medical and commercial benefit, including major opportunities for treatments in cancer and chronic inflammatory diseases.

12. Invion Inc. is a wholly-owned subsidiary of Invion and was formerly called Inverseon Inc. Invion Inc. is a USA resident company which was incorporated in 2004.

13. Invion incorporated a public unlisted company, Chronic Airway Therapeutics Limited (CAT) as a wholly owned subsidiary of Invion. Invion then interposed CAT between Invion Inc. and itself.

14. At the Record Date, Invion had 5,492,272,967 ordinary shares on issue which were held by a mix of resident and non-resident shareholders.

15. The market value of CAT on 11 February 2019 (the Implementation Date) was approximately \$1.7 million.

16. Invion's Annual Report for the year ended 30 June 2018 disclosed:

Issued capital	\$132,140,700
Reserves	\$ 23,771,219
Accumulated losses	\$148,005,574
Total equity	\$ 7,906,345

Return of capital

17. On 21 December 2018, Invion announced that it would undertake an *in specie* distribution on 11 February 2019 (the Implementation Date) whereby Invion would provide one ordinary share in CAT to Invion shareholders for each fully paid ordinary share held in Invion as at 4 February 2019 (the Record Date). The Invion shareholders approved the *in specie* distribution on 30 January 2019.

18. For each CAT share distributed on 11 February 2019 (the Implementation Date), Invion debited its share capital account by an amount of \$0.0003159. This amount is approximately the market value of an ordinary share in CAT at that date. Any adjustments to the Accumulated Losses and the Reserves amounts are unrelated to the *in specie* distribution.

Invion's share capital account

19. Invion debited an amount of \$1,735,264 to its share capital account for the *in specie* distribution.

20. Invion's share capital account (as defined in section 975-300) is not tainted (within the meaning of Division 197).

Other matters

21. To date, Invion has not declared or paid a dividend to its shareholders.

22. At the time of the *in specie* distribution, CAT had no realised or unrealised profits.

23. The market value of Invion's assets that are taxable Australian real property do not exceed the sum of the market value of Invion's other assets for the purposes of section 855-30.

Ruling

Return of capital not a dividend

24. The return of capital provided to Invion shareholders by way of the *in specie* distribution of CAT shares is not a dividend as defined in subsection 6(1).

Application of sections 45A, 45B and 45C

25. The Commissioner will not make a determination under section 45A or section 45B that section 45C applies to any part of the return of share capital paid to Invion shareholders.

Capital gains tax (CGT) consequences***CGT event G1 – section 104-135***

26. CGT event G1 happened to an Invion shareholder when Invion made the *in specie* distribution in respect of the Invion shares that the shareholder owned on 4 February 2019 (the Record Date) and continued to own on 11 February 2019 (the Implementation Date) (section 104-135).

CGT event C2 – section 104-25

27. CGT event C2 happened to an Invion shareholder when Invion made the *in specie* distribution to the Invion shareholder in respect of an Invion share that the shareholder owned at the relevant Record Date, but ceased to own before the *in specie* distribution was made on 11 February 2019 (section 104-25). The amount of the capital gain was \$0.0003159 per CAT share received to the extent that the number of CAT shares received exceeds the number of Invion shares held on the Implementation Date.

CGT cost base and reduced cost base of CAT shares

28. Where either CGT event G1 or CGT event C2 happened to an Invion share, the first element of the cost base and reduced cost base of each CAT share received is equal to \$0.0003159, being the market value of each CAT share, worked out as at the time of their acquisition (the Implementation Date) (subsections 110-25(2) and 110-55(2)).

CGT cost base and reduced cost base of Invion shares

29. Where CGT event G1 happened only, the cost base and reduced cost base of each Invion share is reduced by \$0.0003159 being the amount of the return of capital. The cost base or reduced cost base cannot be less than nil as a result of CGT event G1 happening (subsection 104-135(4)).

Eligibility to discount capital gain treatment

30. A capital gain made when CGT event G1 happened to an Invion share as a result of the return of capital by way of *in specie*

distribution is eligible for CGT discount treatment provided that the Invion shareholder acquired their Invion share on or before 11 February 2018 and the other conditions of Division 115 are satisfied (subsection 115-25(1)).

31. A capital gain made pursuant to CGT event C2 happening to the right to receive the return of capital by way of an *in specie* distribution is not eligible to be treated as a discount capital gain (subsection 115-25(1)).

32. For the purpose of determining entitlement to discount CGT treatment for a CAT share which an Invion Shareholder received under the *in specie* distribution, the shareholder acquired their CAT share on the Implementation Date (11 February 2019) (section 109-5).

33. A capital gain made on a CAT share which was received by an Invion Shareholder under the *in specie* distribution:

- will be eligible to be treated as a discount capital gain under Division 115 provided that the shareholder continued to own the CAT Share and the subsequent CGT event happened to the share on or after 11 February 2020 (subsection 115-25(1)) and the other conditions of that Division are satisfied, or
- will not be eligible to be treated as a discount capital gain under Division 115 where a CGT event happened to the CAT share before 11 February 2020.

Foreign resident shareholders

34. An Invion shareholder who was a foreign resident, or was the trustee of a foreign trust for CGT purposes just before CGT event G1 happened (see paragraph 26 of this Ruling) disregards any capital gain made when CGT event G1 happened to their Invion shares if these shares were not 'taxable Australian property' (sections 855-10 and 855-15).

35. An Invion shareholder who was a foreign resident, or was the trustee of a foreign trust for CGT purposes just before CGT event C2 happened (see paragraph 27 of this Ruling) disregards any capital gain or capital loss made when CGT event C2 happened if their right to receive each CAT Share under the *in specie* distribution was not 'taxable Australian property' (sections 855-10 and 855-15).

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.*

Return of share capital not a dividend

36. The term 'dividend' is defined in subsection 6(1) and includes any distribution made by a company to any of its shareholders including a distribution of property such as shares in a subsidiary company. However, paragraph (d) of the definition of 'dividend' excludes a distribution from the meaning of 'dividend' if the amount of the distribution is debited against an amount standing to the credit of the company's share capital account.

37. The term 'share capital account' is defined in section 975-300 as an account which 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.

38. Subsection 975-300(3) provides that an account is generally taken not to be a share capital account if it is tainted. Invion has confirmed that its share capital account was not tainted within the meaning of Division 197.

39. The return of share capital by way of *in specie* distribution was fully recorded as a debit to Invion's share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) applies and the distribution of share capital was not a dividend as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

40. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of share capital received by Invion shareholders as an unfranked dividend paid by the company out of profits.

Section 45A – streaming of dividends and capital benefits

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

42. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital.

43. The return of share capital by Invion to its shareholders constituted the provision of a capital benefit. However, as Invion made the return of capital to all shareholders that held shares on the Record Date, there was no provision of capital benefits to some shareholders and not to others, contrary to paragraph 45A(1)(a).

44. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the return of share capital.

Section 45B – scheme to provide capital benefits

45. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, subsection 45B(2) applies where:

- there is a scheme where a person is provided with a capital benefit by a company (paragraph 45B(2)(a))
- under the scheme, a taxpayer (relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)), and
- having regard to the relevant circumstances of the scheme, it would be concluded that a person who entered into or carried out the scheme or a part of it did so for a more than incidental purpose of enabling a relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

46. The return of capital by way of *in specie* distribution to Invion shareholders was a scheme within the meaning given by subsection 995-1(1). The Commissioner is also satisfied that at least some Invion shareholders obtained a tax benefit within the meaning of subsection 45B(9) as a result of receiving the return of capital.

47. Subsection 45B(8) sets out a non-exhaustive list of the relevant circumstances of the scheme which one must have regard to when determining whether or not the requisite purpose exists.

48. Having regard to the relevant circumstances of the scheme to return capital to Invion shareholders, the Commissioner considers that it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling Invion shareholders to obtain a tax benefit.

49. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the return of share capital.

Capital gains tax consequences**CGT event G1 – section 104-135**

50. CGT event G1 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 (the non-assessable part) is not
 - a dividend
 - an amount that is taken to be a dividend under section 47, and
 - included in the shareholder's assessable income (section 104-135).

51. CGT event G1 happened to an Invion shareholder when Invion made the *in specie* distribution in respect of their Invion shares that the shareholder owned at the Record Date and continued to own at the time of the distribution. The non-assessable part in respect of the share capital return is \$0.0003159 per Invion share.

52. An Invion shareholder will make a capital gain under CGT event G1 if the non-assessable part is more than the cost base of the shareholder's Invion share. The amount of the capital gain is equal to the excess (subsection 104-135(3)).

53. If an Invion shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of their Invion share is reduced to nil. An Invion shareholder cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3)).

54. If the non-assessable part is not more than the cost base of the resident shareholder's Invion share, the cost base and reduced cost base of the share are reduced by the amount of the non-assessable part (subsection 104-135(4)).

CGT event C2 – section 104-25

55. If, after 4 February 2019 (the Record Date) but before 11 February 2019 (the Implementation date), an Invion shareholder ceased to own an Invion share in respect of which the *in specie* distribution was payable, the right to receive the *in specie* distribution in respect of that share is retained by the Invion shareholder and is a separate CGT asset from the Invion share.

56. In the circumstance described in paragraph 55 of this Ruling, CGT event C2 happened when the *in specie* distribution was made. The right to receive the *in specie* distribution (which is an intangible asset) ended when the right was discharged or satisfied, being when the *in specie* distribution was made (section 104-25).

57. An Invion shareholder made a capital gain as a result of CGT event C2 happening if the capital proceeds from the ending of the

right were more than the cost base of the right. The capital gain is equal to the amount of the excess. An Invion shareholder made a capital loss if the capital proceeds from the ending of the right were less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

58. The capital proceeds will be the market value of the CAT shares received by Invion shareholders (subsection 116-20(1)), in this case \$0.0003159 per CAT share. The market value is worked out at the time when CGT event C2 happened.

59. The cost base of the right of the Invion shareholder to receive the *in specie* distribution is worked out under Division 110 (as modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the Invion share previously owned by an Invion shareholder that was applied in working out a capital gain or capital loss made when a CGT event happened to the Invion share – for example, when the shareholder disposed of the share after the Record Date. Therefore, the right to receive the *in specie* distribution has a nil cost base. As a result, the Invion shareholder will make a capital gain equal to the capital proceeds, being \$0.0003159 per Invion share.

Discount capital gain treatment

CGT event G1 happening to Invion shares

60. A capital gain made when CGT event G1 happened to an Invion share when the *in specie* distribution was made is eligible to be treated as a discount capital gain under Division 115 provided that the Invion shareholder acquired their Invion share at least 12 months before the CGT event (subsection 115-25(1)) – that is, on or before 11 February 2018 – and the other conditions of Division 115 are satisfied.

No discount capital gain where CGT event C2 happened

61. The right to receive the *in specie* distribution was acquired at the time when the right was created (section 109-5). This would be no earlier than when the Invion shareholders approved the return of share capital by Invion.

62. As the right to receive the return of share capital (in the form of an *in specie* distribution) was not acquired by an Invion shareholder at least 12 months before the distribution was made, any capital gain made from CGT event C2 happening on the ending of the corresponding right will not satisfy subsection 115-25(1). The capital gain made when CGT event C2 happened is not eligible to be treated as a discount capital gain.

Eligibility for CAT shares

63. A capital gain made when a subsequent CGT event happens to a CAT share which was received by an Invion shareholder under the *in specie* distribution is eligible to be treated as a discount capital gain under Division 115 provided that the shareholder continued to hold the CAT share for at least 12 months before the subsequent CGT event (subsection 115-25(1)) – that is, continued to hold the CAT share until a subsequent CGT event happens on or after 11 February 2020 – and the other conditions of Division 115 are satisfied.

Foreign resident shareholders

64. Under subsection 855-10(1), an entity disregards a capital gain or capital loss made from a CGT event if both:

- just before the CGT event happened, the entity is a foreign resident, or the trustee of a foreign trust for CGT purposes, and
- the CGT event happens in relation to a CGT asset that is not ‘taxable Australian property’.

65. The term ‘taxable Australian property’ is defined in the table in section 855-15. The table sets out five categories of CGT assets:

Item 1	taxable Australian real property
Item 2	an indirect Australian real property interest and that is not covered by item 5
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and that is not covered by item 1, 2 or 5
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident)

66. An Invion shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event C2 happened to the shareholder’s right to receive a return of share capital (in the form of an *in specie* distribution of CAT shares) if the right had been used at any time by them in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15).

67. An Invion shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event G1 happened to their Invion share under subsection 855-10(1) if:

- (a) the shareholder used their Invion share at any time in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15), or
- (b) their Invion share was covered by subsection 104-165(3) (item 5 of the table in section 855-15).

68. When CGT event G1 happened to Invion shares held by a foreign resident Invion shareholder, the Invion shares did not constitute an 'indirect interest in Australian real property' (item 2 of the table in section 855-15). Although the event happened to Invion shares which are membership interests, the Invion shares did not pass the principal assets test (paragraph 855-25(1)(b)). This is because the market value of Invion's assets that are taxable Australian real property did not exceed the sum of the market value of Invion's other assets for the purposes of section 855-30. The exception in Item 2 does not apply when item 5 of the table in section 855-15 applies.

Appendix 2 – Detailed contents list

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

	Paragraph
Summary – what this Ruling is about	1
Relevant provisions	2
Class of entities	3
Qualifications	4
Date of effect	8
Scheme	9
Background	10
Return of capital	17
Invion's share capital account	19
Other matters	21
Ruling	24
Return of capital not a dividend	24
Application of sections 45A, 45B and 45C	25
Capital gains tax (CGT) consequences	26
<i>CGT event G1 – section 104-135</i>	26
<i>CGT event C2 – section 104-25</i>	27
CGT cost base and reduced cost base of CAT shares	28
CGT cost base and reduced cost base of Invion shares	29
Eligibility to discount capital gain treatment	30
Foreign resident shareholders	34
Appendix 1 – Explanation	36
Return of share capital not a dividend	36
The application of sections 45A, 45B and 45C	40
<i>Section 45A – streaming of dividends and capital benefits</i>	41
<i>Section 45B – scheme to provide capital benefits</i>	45
Capital gains tax consequences	50
<i>CGT event G1 – section 104-135</i>	50
<i>CGT event C2 – section 104-25</i>	55
Discount capital gain treatment	60
<i>CGT event G1 happening to Invion shares</i>	60
<i>No discount capital gain where CGT event C2 happened</i>	61

CR 2019/13

<i>Eligibility for CAT shares</i>	63
Foreign resident shareholders	64
Appendix 2 – Detailed contents list	69

References

<i>Previous draft:</i>	- ITAA 1997 104-135
Not previously issued as a draft	- ITAA 1997 104-135(3)
	- ITAA 1997 104-135(4)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 104-165(3)
TR 2006/10	- ITAA 1997 109-5
	- ITAA 1997 Div 110
<i>Legislative references:</i>	- ITAA 1997 110-25
- ITAA 1936	- ITAA 1997 110-25(2)
- ITAA 1936 6(1)	- ITAA 1997 110-55(2)
- ITAA 1936 45A	- ITAA 1997 Div 112
- ITAA 1936 45A(1)(a)	- ITAA 1997 112-20
- ITAA 1936 45A(2)	- ITAA 1997 Div 115
- ITAA 1936 45A(3)(b)	- ITAA 1997 115-25(1)
- ITAA 1936 45B	- ITAA 1997 116-20(1)
- ITAA 1936 45B(2)	- ITAA 1997 Div 197
- ITAA 1936 45B(2)(a)	- ITAA 1997 Div 230
- ITAA 1936 45B(2)(b)	- ITAA 1997 855-10
- ITAA 1936 45B(2)(c)	- ITAA 1997 855-10(1)
- ITAA 1936 45B(3)	- ITAA 1997 855-15
- ITAA 1936 45B(3)(b)	- ITAA 1997 855-25(1)(b)
- ITAA 1936 45B(8)	- ITAA 1997 855-30
- ITAA 1936 45B(9)	- ITAA 1997 975-300
- ITAA 1936 45C	- ITAA 1997 975-300(3)
- ITAA 1936 47	- ITAA 1997 977-50
- ITAA 1997	- ITAA 1997 995-1(1)
- ITAA 1997 104-25	- TAA 1953
- ITAA 1997 104-25(3)	

ATO references

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