

# ***CR 2008/31 - Income tax: demerger of Autogen Research Pty Ltd by ChemGenex Pharmaceuticals Ltd***



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## Class Ruling

### Income tax: demerger of Autogen Research Pty Ltd by ChemGenex Pharmaceuticals Ltd

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#### **① 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 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);
- Division 110 of the ITAA 1997;
- section 115-30 of the ITAA 1997 and
- Division 125 of ITAA 1997.

## Class of entities

3. The class of entities to which this Ruling applies is the shareholders of ChemGenex Pharmaceuticals Ltd (ChemGenex) who:

- (a) participate in the scheme that is the subject of this Ruling;
- (b) own ordinary shares in ChemGenex and hold those on capital account at the time of the demerger; and
- (c) are residents of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time of the demerger.

This class of entities are referred to as the 'participating ChemGenex shareholders' in this Ruling.

## 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 13 to 39 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 2007 to 30 June 2008. 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.

9. 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.

10. If this 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)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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.

12. 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).

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## Scheme

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13. The following description of the scheme is based on information provided by Ernst & Young (the applicant for this Ruling).

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

### Background

14. The scheme that is the subject of this Ruling involves the demerger by ChemGenex of Autogen Research Pty Ltd (Autogen).

## **ChemGenex**

15. ChemGenex is an Australian resident company listed on the Australian Securities Exchange (ASX).

16. ChemGenex is a biopharmaceutical development company that has significant expertise in the discovery of new therapeutic targets and the development of drugs in the fields of cancer (oncology) and metabolic syndrome diseases (diabetes and obesity).

17. At the time of the demerger, ChemGenex had 186,754,905 ordinary shares on issue. It also had 39,910,672 options on issue comprising:

- 33,451,172 options listed on the ASX (the listed options); and
- 6,459,500 options that are not listed on the ASX (the unlisted options).

18. There were no other ownership interests in ChemGenex just before the demerger.

19. At the time of the demerger, the unlisted options were qualifying rights within the meaning of section 139CD of the ITAA 1936 and represented approximately 1.86% of all ownership interests in ChemGenex.

20. At the time of the demerger, the listed options represented approximately 7.65% of all ownership interests in ChemGenex. As a consequence of the demerger the price at which these options can be exercised was reduced.

## **Autogen**

21. Autogen is an Australian resident company. Just before the demerger it was a wholly-owned subsidiary of ChemGenex.

22. Autogen undertakes research and development of drug therapies for the treatment of diabetes and obesity. At the time of the demerger, Autogen had 37,350,891 ordinary shares on issue.

23. There were no other ownership interests in Autogen just before the demerger.

## **Pre-demerger transactions**

24. Before the demerger, Autogen changed its name to Verva Pharmaceuticals Ltd.

25. Before the demerger, ChemGenex transferred certain assets to Autogen which relate to the carrying on of the diabetes and obesity research business. Included in those assets were cash funds in the amount of \$150,000.

26. Before the demerger, Autogen had an outstanding loan from ChemGenex in the amount of approximately \$26 million. That loan amount was advanced by ChemGenex to Autogen to allow it to fund its diabetes research. The loan was fully discharged before the demerger in the following manner:

- ChemGenex forgave approximately \$13.5 million of the loan amount; and
- approximately \$12.5 million of the loan amount was repaid under a *debt for equity* swap arrangement, with ChemGenex subscribing for approximately \$12.5 million of ordinary shares in Autogen.

### **The demerger**

27. At an Annual General Meeting held on 28 November 2007, the ChemGenex shareholders agreed to the demerger of Autogen. The ChemGenex shareholders passed resolutions approving:

- a capital reduction by way of an *in specie* distribution of Autogen ordinary shares; and
- a reduction in the exercise price of the listed and unlisted options in ChemGenex.

28. The ChemGenex shareholders received 1 Autogen share for every 5 ChemGenex shares they owned just before the demerger. A total of 37,350,891 Autogen shares were distributed to the ChemGenex shareholders.

### **Accounting for the demerger**

29. ChemGenex accounted for the demerger as a return of share capital satisfied by the *in specie* distribution of the Autogen shares in the following manner:

Dr	Share capital	\$12.5 million
	Cr      Distribution payable	\$12.5 million
and		
Dr	Distribution payable	\$12.5 million
	Cr      Shares in Autogen	\$12.5 million

30. As a consequence, the ChemGenex shareholders received a return of capital amount of \$12.5 million in total, and approximately 7 cents per ordinary ChemGenex share owned on the relevant Record Date (the capital reduction amount).

## Reasons for the demerger

31. The demerger was undertaken to allow ChemGenex and Autogen to separately pursue research and development in the areas of oncology and diabetes. The demerger allows each company to better pursue independently focused strategies that are consistent with its strengths and capabilities in the particular field in which it operates.

32. The demerger will allow industry specific Board of Director membership and senior management to be appointed so as to contribute to the independently focussed operations of each entity by providing expertise and making decisions on operational issues as they specifically relate to the separate businesses.

## Post-demerger transactions

33. After the demerger, ChemGenex will undertake a further reduction of its share capital in the amount of \$17.9 million under section 256B of the *Corporations Act 2001*.

34. After the demerger, Autogen will also appoint new directors to its Board. Autogen will apply for listing on the ASX or other suitable stock exchange in the first half of the 2008 calendar year. Autogen will then seek to raise \$8 million to \$10 million of funds for its diabetes and obesity discovery programme. This fund raising will take place through a public offering of shares, private share placement, through strategic partnerships, or a combination of these. This fund raising is not part of the corporate restructure of ChemGenex.

35. Autogen has also entered into a Merger Implementation Agreement which was executed on 29 October 2007 under which it is proposed that Autogen will acquire all of the shares in another company involved in research and development of drug therapies for the treatment of diabetes.

## Other matters

36. ChemGenex is the head company of a consolidated group for tax law purposes, and at the time of the demerger, Autogen was a member of that consolidated group.

37. ChemGenex 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. This means that ChemGenex's share capital account is not tainted for the purposes of paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936.

38. Just after the demerger, at least 50% of the market value of capital gains tax (CGT) assets owned by Autogen were used in the carrying on of a business by that entity (subsection 44(5) of the ITAA 1936). This is a necessary condition for subsections 44(3) and 44(4) of the ITAA 1936 to apply to the demerger dividend. Subsection 44(3) deems that a demerger dividend has not been paid out of profits, while subsection 44(4) deems that a demerger dividend is not assessable income or exempt income.

39. ChemGenex did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 not apply to any demerger dividend paid under this scheme. Consequently, the demerger dividend will be treated as not being paid out of profits and will not be assessable income or exempt income.

## **Ruling**

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### **(A) CGT consequences**

#### **CGT event G1**

40. CGT event G1 happened in relation to each of the ChemGenex ordinary shares at the time ChemGenex made the payment of the capital reduction amount (section 104-135 of the ITAA 1997).

41. Participating ChemGenex shareholders made a capital gain under CGT event G1 if the capital reduction amount (of approximately 7 cents per ChemGenex share) exceeded the cost base of the ChemGenex share (subsection 104-135(3) of the ITAA 1997).

#### **Disregarding the capital gain under CGT event G1**

42. Participating ChemGenex shareholders who acquired their ChemGenex share before 20 September 1985 (pre-CGT share) will disregard the capital gain made under CGT event G1 (subsection 104-135(5) of the ITAA 1997).

43. Participating ChemGenex shareholders who acquired their ChemGenex share after 19 September 1985 (post-CGT share) will disregard the capital gain made under CGT event G1 if they choose demerger roll-over relief (subsection 125-55(1) and subsection 125-80(1) of the ITAA 1997).

#### **Participating ChemGenex shareholders who choose demerger roll-over relief**

44. A demerger, as described under section 125-70 of the ITAA 1997, happened under the scheme. Therefore, participating ChemGenex shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their pre-CGT and post-CGT ChemGenex shares.



## ***Consequences of choosing demerger roll-over relief***

45. As noted at paragraph 43 of this Ruling, any capital gain made under CGT event G1 that happens under the demerger is disregarded. The other CGT consequences from choosing demerger roll-over relief will depend on whether the choice is made for:

- (a) a pre-CGT ChemGenex share; or
- (b) a post-CGT ChemGenex share.

### *Choosing demerger roll-over relief for pre-CGT ChemGenex shares*

46. Participating ChemGenex shareholders who choose demerger roll-over relief for their pre-CGT ChemGenex shares will be taken to have acquired the corresponding Autogen shares received under the demerger before 20 September 1985 (as pre-CGT shares) (subsection 125-80(6) of the ITAA 1997).

### *Choosing demerger roll-over relief for post-CGT ChemGenex shares*

47. Where a participating ChemGenex shareholder chooses demerger roll-over relief for their post-CGT ChemGenex shares, the first element of the cost base (and reduced cost base) of each post-CGT ChemGenex share and corresponding Autogen share received under the demerger is worked out by taking the sum of the cost bases of their post-CGT ChemGenex shares (just before the demerger) and then apportioning that sum over their remaining post-CGT ChemGenex shares and corresponding new Autogen shares received under the demerger. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the ChemGenex and Autogen shares, or a reasonable approximation of those market values (subsections 125-80(2) and (3) of the ITAA 1997).

## **Participating ChemGenex shareholders who do not choose demerger roll-over relief**

48. The CGT consequences for ChemGenex shareholders who do not choose demerger rollover relief will depend on whether it relates to:

- (a) a pre-CGT ChemGenex share; or
- (b) a post-CGT ChemGenex share.

***Participating ChemGenex shareholders who own pre-CGT ChemGenex shares***

49. For participating ChemGenex shareholders who own pre-CGT ChemGenex shares and who do not choose demerger roll-over relief:

- none of the corresponding Autogen shares received under the demerger will be taken to be pre-CGT shares;
- those Autogen shares are acquired on the date of the demerger (13 December 2007); and
- the first element of the cost base of those Autogen shares will be calculated in accordance with the rules in Division 110 of the ITAA 1997.

***Participating ChemGenex shareholders who own post-CGT ChemGenex shares***

50. Participating ChemGenex shareholders who own post-CGT ChemGenex shares and who do not choose demerger roll-over relief:

- are not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their post-CGT ChemGenex shares under the demerger; and
- the first element of the cost base and reduced cost base of each post-CGT ChemGenex share and the corresponding Autogen shares is calculated in the manner described in paragraph 47 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997).

***Acquisition date of the Autogen shares for the purposes of the CGT discount***

51. For the purpose of accessing the CGT discount, the Autogen shares received in relation to the post-CGT ChemGenex shares under the demerger, are taken to be acquired on the same date as the corresponding ChemGenex shares (subsection 115-30(1) of the ITAA 1997 (item 2)). This will be the case whether demerger roll-over relief is chosen or not.

52. For Autogen shares received in relation to pre-CGT ChemGenex shares under the demerger where demerger roll-over relief is not chosen, the acquisition date of those Autogen shares is the date of the demerger (13 December 2007) for the purposes of accessing the CGT discount.

## **(B) Dividend consequences**

### **Demerger dividend**

53. Any dividend arising under the demerger will be a demerger dividend (subsection 6(1) of the ITAA 1936).

54. The demerger dividend will be neither assessable income nor exempt income of the participating ChemGenex shareholders (subsections 44(3) and (4) of the ITAA 1936).

55. As the capital reduction amount will be debited to ChemGenex's share capital account it will not be a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion contained in paragraph (d) of the definition of a dividend in subsection 6(1) of the ITAA 1936).

### **Application of sections 45B, 45BA and 45C**

56. 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 participating ChemGenex shareholders under the demerger.

57. 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 ChemGenex shareholders under the demerger.

## 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.*

58. The tax consequences and relevant legislative provisions that arise concerning the scheme that is the subject of this Ruling are outlined in the Ruling part of this document.

59. The significant tax consequence is that the distribution of the Autogen shares described in the scheme to which this Ruling relates happened under a demerger for the purposes of the ITAA 1997 and the ITAA 1936.

### **Demerger roll-over relief**

60. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions for eligibility to choose demerger roll-over relief. The main conditions that are relevant to the scheme to which this Ruling relates are:

- (i) a shareholder owns a share in a company;
- (ii) the company is the head entity of a demerger group;
- (iii) a demerger happens to the demerger group; and
- (iv) under the demerger a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity.

61. Under the scheme to which this Ruling relates the conditions for demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied. Further, the scheme to which this Ruling relates raises no novel issues of tax law interpretation and no further explanation of the application of those tax laws beyond that contained in the Ruling part of this document is necessary.

### **Section 45B – schemes to provide certain benefits**

62. 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.

63. 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 participating ChemGenex shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

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

65. Consequently, participating ChemGenex shareholders can choose CGT demerger roll-over relief and are subject to the dividend concessions as outlined in detail in the Ruling part of this document and no further explanation beyond that contained in the Ruling part of this document is necessary.

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

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

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## References

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### *Previous draft:*

Not previously issued as a draft

### *Subject references:*

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary

### *Legislative references:*

- ITAA 1936 6(1)
  - ITAA 1936 44
  - ITAA 1936 44(2)
  - ITAA 1936 44(3)
  - ITAA 1936 44(4)
  - ITAA 1936 44(5)
  - 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 1936 139CD
  - ITAA 1997 104-135
  - ITAA 1997 104-135(3)
  - ITAA 1997 104-135(5)
  - ITAA 1997 Div 110
  - 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 125-80(6)
  - ITAA 1997 125-85(1)
  - ITAA 1997 125-85(2)
  - ITAA 1997 975-300
  - TAA 1953
  - TAA 1953 Sch 1 357-75(1)
  - Corporations Act 2001 256B
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### ATO references

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