


CR 2008/49 - Income tax: Demerger of Impedance Cardiology Systems Inc. by ImpediMed Limited

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Class Ruling

Income tax: Demerger of Impedance Cardiology Systems Inc. by ImpediMed Limited

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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 provisions 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);
- 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 ImpediMed Limited (ImpediMed) who:

- (a) participate in the scheme that is the subject of this Ruling;
- (b) own ordinary or preference shares in ImpediMed and hold the shares 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 is referred to, collectively and individually, as the 'participating ImpediMed 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 was carried out in accordance with the scheme described in paragraphs 13 to 39 of this Ruling.

6. If the scheme actually carried out was 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 2006 to 30 June 2007. However, the Ruling continues to apply after 30 June 2007 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).

Scheme

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

Note: where certain information has been provided by Johnston Rorke on a commercial-in-confidence basis it 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 ImpediMed of Impedance Cardiology Systems Inc. (ICS).

ImpediMed

15. ImpediMed is an Australian resident company incorporated on 27 September 1999. At the time of this scheme, it had ninety-seven shareholders.

16. ImpediMed develops bioimpedance devices with a focus on medical applications in three areas of cardiology, lymphedema and body composition. These devices are used in a variety of healthcare segments for the determination of body fluid volumes and body composition.

17. In 2005, ImpediMed acquired 100% of the share capital of Aorora Technologies Pty Ltd (Aorora), an Australian resident company. Aorora owns patents required for the expansion of the cardiology segment of ImpediMed's business.

18. At the time of the demerger, ImpediMed had the following ownership interests on issue:

- 22,789,361 fully paid ordinary shares;
- 2,889,436 preference A1 shares;
- 3,257,544 preference A2 shares;
- 747,673 options issued to the Chief Executive Officer of ImpediMed (CEO options);
- 250,000 options issued to persons engaged as consultants to ImpediMed (consultant options); and
- 570,000 options issued to employees under an employee share option plan (ESOP) (employee options).

19. There were no other ownership interests in ImpediMed just before the demerger.

Impedance Cardiology Systems Inc

20. ICS was incorporated in the USA in July 2006 as a wholly owned subsidiary of ImpediMed. Upon incorporation, ICS issued ImpediMed with 1,000 common shares.

21. On 7 July 2006, the cardiology business of ImpediMed (including goodwill, intellectual property and the shares in Aorora) was transferred to ICS. ImpediMed also transferred cash in the amount of \$1,185,450 to ICS. As consideration for the transfer of these assets, ICS issued the following shares to ImpediMed:

- 22,788,361 common shares;
- 2,889,436 preference A1 shares; and
- 3,257,544 preference A2 shares.

22. As a consequence, just before the demerger ICS had the following ownership interests on issue:

- 22,789,361 common shares;
- 2,889,436 preference A1 shares; and
- 3,257,544 preference A2 shares.

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

The demerger

24. ImpediMed undertook a demerger on 30 October 2006 by:

- transferring the ICS common shares and preference shares to the ImpediMed shareholders; and
- causing ICS to issue new options to the ImpediMed option holders.

25. The following table shows the ImpediMed ownership interests held at the time of the demerger and the ICS ownership interests transferred or issued in respect of each of the types of ImpediMed ownership interest:

<i>Type of ownership interest</i>	<i>Number of ImpediMed ownership interests held just before the demerger</i>	<i>Number of ICS interests transferred or issued under the demerger</i>
Ordinary shares (or common shares)	22,789,361	22,789,361
Preference A1 shares	2,889,436	2,889,436
Preference A2 shares	3,257,544	3,257,544
CEO options	747,673	747,673
Consultant options	250,000	250,000
Employee options	570,000	570,000

Owners of ordinary shares in ImpediMed

26. ImpediMed undertook the demerger of the ICS common shares by way of a capital reduction and the payment of a dividend to the ImpediMed ordinary shareholders. The capital reduction and dividend was satisfied by the *in specie* transfer of one ICS common share for each ImpediMed ordinary share owned at the time of the demerger.

27. ImpediMed accounted for the holding of, and subsequent distribution of the common ICS shares as follows:

- the book value of the ICS common shares in the accounts of ImpediMed was increased from \$1,471,758 to \$8,354,600;
- ImpediMed made a distribution (satisfied by the *in specie* distribution of ICS common shares) to the owners of ordinary shares as follows:
 - share capital of \$1,471,758 (or 6.458 cents per ordinary ImpediMed share) by way of a capital reduction made pursuant to section 256B of the *Corporations Act 2001* (the ordinary share capital reduction amount); and
 - profit of \$6,882,842 (or 30.203 cents per ordinary ImpediMed share).

Owners of preference shares in ImpediMed

28. The distribution by ImpediMed of the ICS preference shares under the demerger was accounted for as a reduction in the liability ImpediMed recognised in its accounts for the preference shares that it had on issue. (The \$6,222,721 paid by the subscribers for the issue of ImpediMed preference shares was recorded, for accounting purposes, as a liability in the accounts of ImpediMed.)

29. The owners of the ImpediMed preference shares resolved, pursuant to section 256B of the *Corporations Act 2001* to reduce share capital in the amount of:

- \$901,796 (approximately 31.210 cents per preference share) in the case of the ImpediMed A1 preference shares, with that capital reduction being satisfied by the *in specie* distribution of the ICS A1 preference shares; and
- \$987,106 (approximately 30.302 cents per preference share) in the case of the ImpediMed A2 preference shares, with that capital reduction being satisfied by the *in specie* distribution of the ICS A2 preference shares.
(in each case, the preference share capital reduction amount)

30. The amount of the capital reduction in each case was determined by the market value of ICS relative to ImpediMed (just before the demerger). The Directors of ImpediMed determined that ICS accounted for 30.3549% of the value of ImpediMed just before the demerger, and as a consequence the capital return amount (reduction in preference share liability) was 30.3549% of the original preference share capital subscribed. This is shown in the following table:

<i>Tranche of preference shares</i>	<i>Original capital subscribed per preference share</i>	<i>Reduction in capital per preference share (30.3549%)</i>	<i>Share capital just after demerger (recorded as a liability)</i>
Preference A1 shares (2,889,436 shares)	\$1.028173	\$0.3121009	\$0.7160721
Preference A2 shares (3,257,544 shares)	\$0.998262	\$0.3030216	\$0.6952404

Owners of options in ImpediMed

31. Under the demerger, the options in ImpediMed were treated as follows:

- the exercise price under each ImpediMed option was reduced by the ratio of the market value, just before the demerger, of ICS relative to ImpediMed (30.3549%); and
- ImpediMed caused ICS to issue one new ICS option for each ImpediMed option owned at the time of the demerger, and the exercise price set for these options is the same as the reduction in exercise price for the ImpediMed options.

32. No accounting for the change in exercise price and issue of new options was undertaken by ImpediMed.

Reasons for the demerger

33. The demerger was undertaken for the following reasons:

- Financing research activities – ImpediMed's management believed that the demerger of a USA resident company would allow it to attract the necessary funding to allow it to further develop the ImpediMed bioimpedance business and the ICS cardiology business;
- Further research activities – ImpediMed's management believed that the performance of medical trials and the final development stages of the bioimpedance product would be significantly facilitated if the associated intellectual property and key personnel were also based in the USA;

- Commercialisation of developed products – since the production and commercialisation of products developed by ImpediMed require significant injections of capital, ImpediMed management believed obtaining financial support would be improved if the risks associated with production and commercialisation of each product are quarantined; and
- Asset protection – ImpediMed management believed that the transfer of some of the business risks to a separate company provided ImpediMed's shareholders with greater security for their investment.

Other matters

34. ImpediMed has not elected to consolidate for taxation purposes.

35. All of the ownership interests in ImpediMed are post-CGT interests (acquired after 19 September 1985).

36. Neither ICS nor ImpediMed were, at the time of the demerger, listed for trading on a Securities Exchange.

37. ImpediMed did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and 44(4) of the ITAA 1936 not apply to any demerger dividend paid under the scheme.

38. At least 50% of the market value of all CGT assets owned by ICS and its demerger subsidiaries were used (just after the demerger), directly or indirectly in one or more businesses carried on by ICS and its demerger subsidiaries.

39. At the time of the demerger the share capital account, as defined in section 975-300 of the ITAA 1997, of ImpediMed did not include a tainted amount within the meaning of that term in section 197-50 of the ITAA 1997.

Ruling

(a) Capital gains tax consequences

Capital event G1

40. CGT event G1 happened in relation to the ImpediMed shares owned by the participating ImpediMed shareholders at the time ImpediMed made the payment of the share capital reduction amount (section 104-135 of the ITAA 1997).

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

Disregarding the capital gain under CGT event G1 by choosing demerger roll-over relief

42. A demerger, as described under section 125-70 of the ITAA 1997, happened under the scheme.

43. Therefore, participating ImpediMed shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their ImpediMed shares.

44. Participating ImpediMed shareholders will disregard any capital gain made under CGT event G1 if they choose demerger roll-over relief (subsections 125-55(1) and 125-80(1) of the ITAA 1997).

Other consequences of choosing demerger roll-over relief

45. If a participating ImpediMed shareholder chooses demerger roll-over relief, they must also recalculate the cost base and reduced cost base of the ImpediMed and ICS shares.

46. The first element of the cost base (and reduced cost base) of the ImpediMed shares and corresponding ICS shares received under the demerger is worked out by taking the sum of the cost bases of the participating ImpediMed shareholders shares (just before the demerger) and then apportioning that sum over their remaining ImpediMed shares and corresponding new ICS 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 ImpediMed shares and ICS shares, or a reasonable approximation of those market values (subsections 125-80(2) and (3) of the ITAA 1997).

Participating ImpediMed shareholders who do not choose demerger roll-over relief

47. For participating ImpediMed shareholders who do not choose demerger roll-over relief:

- they are not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their ImpediMed shares under the demerger; and
- the first element of the cost base and reduced cost base of the ImpediMed shares and the corresponding ICS shares is calculated in the manner described in paragraph 46 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997).

Acquisition date of the ICS shares for the purposes of the CGT discount

48. For the purpose of accessing the CGT discount, the ICS shares received by the participating ImpediMed shareholders are taken to have been acquired on the same date as the corresponding ImpediMed shares (item 2 of subsection 115-30(1) of the ITAA 1997). This will be the case whether demerger roll-over relief is chosen or not.

(b) Dividend consequences

Demerger dividend

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

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

51. As the ordinary share capital reduction amount and the preference share capital reduction amount was debited to ImpediMed's share capital accounts, 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

52. 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 ImpediMed shareholders under the demerger.

53. 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 ImpediMed 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.*

CGT event G1

54. CGT event G1 happened in relation to the ImpediMed shares owned by the participating ImpediMed shareholders at the time that ImpediMed made the payment of the capital reduction amount as the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount taken to be a dividend under section 47 of the ITAA 1936 (section 104-135 of the ITAA 1997).

55. An ImpediMed shareholder will make a capital gain if the capital reduction amount is more than the cost base of their ImpediMed share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

56. An ImpediMed shareholder cannot make a capital loss when CGT event G1 happens (note 1 of subsection 104-135(3) of the ITAA 1997).

57. If the ImpediMed share to which the payment relates was acquired by an ImpediMed shareholder at least 12 months before the payment of the capital reduction amount, a capital gain made from CGT event G1 may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

Demerger roll-over relief

58. Demerger roll-over enables a shareholder to choose to disregard a capital gain made as a result of CGT event G1 happening when a non-assessable payment is made in relation to a share under a demerger.

59. 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.

60. 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

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. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) of the ITAA 1936 empowers the Commissioner to make a determination that either section 45BA of the ITAA 1936 applies in relation to a demerger benefit or section 45C of the ITAA 1936 applies in relation to a capital benefit.

63. In this case, while the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met, the requisite purpose of enabling the participating ImpediMed 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 paragraphs 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.

Conclusion

65. Consequently, participating ImpediMed shareholders can choose CGT demerger roll-over and are subject to the dividend concessions as outlined in the Ruling part of this document.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

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

Legislative references:

- ITAA 1936 6(1)
 - ITAA 1936 6(1)(d)
 - ITAA 1936 44
 - ITAA 1936 44(2)
 - ITAA 1936 44(3)
 - ITAA 1936 44(4)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - 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 197-50
 - ITAA 1997 975-300
 - ITAA 1997 995-1(1)
 - Corporations Act 2001 256B
 - TAA 1953
 - TAA 1953 Sch 1 357-75(1)
 - Copyright Act 1968
-

ATO references

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ATOlaw topic: Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 – shares

Income Tax ~~ Capital Gains Tax ~~ demerger relief

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