


CR 2015/85 - Income tax: demerger of TSV Montney Ltd by Transerv Energy Limited

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Class Ruling

Income tax: demerger of TSV Montney Ltd by Transerv Energy Limited

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

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

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

Relevant provision(s)

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) 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)
- section 115-30 of the ITAA 1997, and
- Division 125 of the ITAA 1997.

Class of entities

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

- participated in the scheme that is the subject of this Ruling
- were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Implementation Date of the scheme (20 October 2015)
- were listed on the share register of Transerv on the Record Date of the scheme (8 October 2015)
- owned ordinary shares in Transerv on the Record Date and held those shares on capital account at the time of the demerger and not as trading stock or revenue assets, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their ordinary shares in Transerv.

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

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

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. 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 32 of this Ruling.

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 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

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

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

Background

10. The subject of this Ruling is the demerger transaction involving the distribution of TSV Montney Ltd (TSV Montney) shares by Transerv which occurred on 20 October 2015.

Relevant entities

Transerv

11. Transerv is an Australian resident public company incorporated on 22 July 1997 and listed on the Australian Securities Exchange (ASX) on 10 March 2004.

12. Transerv is the head company of an Australian income tax consolidated group for the purposes of Part 3-90 of the ITAA 1997 (the Transerv tax consolidated group).

13. Transerv is an Australian oil and gas exploration company headquartered in Perth with significant projects in Western Australia and Canada.

14. Just before the demerger, Transerv had the following shares and options on issue:

- 806,819,893 fully paid ordinary shares
- 28,000,000 unlisted options

15. There are no other ownership interests in Transerv.

16. As at 30 June 2015, Transerv had issued share capital of \$66,952,804 and Transerv did not have positive retained earnings.

17. Transerv has never paid any dividends since its incorporation.

TSV Montney

18. TSV Montney is an Australian resident company. TSV Montney was incorporated on 4 August 2015.

19. Just before the demerger:

- TSV Montney was wholly-owned by Transerv
- TSV Montney was a member of the Transerv tax consolidated group

- Transerv held all the TSV Montney shares on issue
- Transerv owned shares in TSV Montney that carried between them the right to:
 - receive 100% of any distribution of income or capital by TSV Montney, and
 - exercise, or control the exercise of, 100% of the voting power of TSV Montney
- Transerv held all the TSV Montney shares as a CGT asset on capital account, and
- there were no other ownership interests in TSV Montney, as defined in subsection 125-60(1) of the ITAA 1997.

The demerger

20. The demerger of TSV Montney occurred on the Implementation Date when Transerv:

- undertook a capital reduction, returning 21.69% of the original capital contributed, and
- made an in specie distribution of all the shares in TSV Montney to holders of ordinary shares in Transerv.

21. Transerv shareholders received one TSV Montney share for every 10 Transerv shares held on the Record Date.

22. Concurrently with the above, TSV Montney issued to existing Transerv option holders one option in TSV Montney for every 10 Transerv options held by the Transerv option holder.

23. The TSV Montney options are exercisable at 21 cents each on or before 31 March 2019.

24. No other distribution was received by the Transerv shareholders from Transerv.

Reasons for the demerger

25. Transerv's reasons for undertaking the demerger were as follows:

- The demerger will enable TSV Montney to attract investors based on their profile and appetite for risk and investment in their projects without the other projects weighing upon the investor's investment decisions.
- TSV Montney would, as a dedicated corporate vehicle, more likely attract the private funding needed to take it through to development.

- TSV Montney will be able to focus existing management and staff as well as secure new skilled management and staff who will more efficiently execute the appraisal and development phase. Having a management team with the sole objective to develop TSV Montney's assets should lead the project to being executed in a more timely and efficient manner.
- Becoming an unlisted company will remove continuous disclosure requirements under the ASX Listing Rules allowing TSV Montney to keep price sensitive drilling data confidential. This will give TSV Montney a commercial advantage in executing land bids, undertaking neighbouring acquisitions and negotiating infrastructure access rights. This drilling data has become necessary as a result of the recent reduction in the price of oil which has reduced drilling activity in the area, reduced the industry's enthusiasm for undrilled lands and made prospective investors more selective and sensitive to opportunities complicated by overseas owners.

Accounting treatment

26. Transerv accounted for the capital reduction and the distribution of TSV Montney shares effecting the demerger by reducing the share capital account and removing the net assets of TSV Montney from the consolidated accounts of Transerv. There were no other accounting entries.

Other matters

27. Just after the demerger, more than 50% of the market value of CGT assets owned by TSV Montney and its demerged subsidiaries will be used directly in the carrying on of TSV Montney's business.

28. Following the demerger, Transerv will continue to be an ASX listed company, while TSV Montney will continue to be an Australian incorporated unlisted entity. Transerv does not own any shares in TSV Montney (or vice versa).

29. Transerv did not make an election under subsection 44(2) of the ITAA 1936.

30. No Transerv shareholder acquired their Transerv shares before 20 September 1985.

31. No Transerv shares were bought-back under the demerger.

32. Transerv's share capital account is not tainted as defined in Division 197 of the ITAA 1997.

Ruling

Capital gains tax (CGT)

CGT event G1

33. CGT event G1 happened in relation to each Transerv share owned by a Transerv shareholder at the time Transerv made the payment of the capital reduction amount satisfied by the in specie distribution of TSV Montney shares (section 104-135 of the ITAA 1997).

34. A Transerv shareholder made a capital gain when CGT event G1 happened if the capital reduction amount of each Transerv share exceeded the cost base of that Transerv share. The capital gain is equal to the amount of the excess (section 104-135(3) of the ITAA 1997).

35. No capital loss can be made from CGT event G1 (Note 1 to subsection 104-135(3) of the ITAA 1997).

Acquisition date of TSV Montney shares

36. For CGT purposes, a Transerv shareholder acquired their TSV Montney share on the date that the TSV Montney share was transferred to them by Transerv (subsection 109-5(2) of the ITAA 1997).

37. However, for the purposes of determining eligibility for a discount capital gain, a TSV Montney share received by a Transerv shareholder under the demerger is taken to have been acquired on the same date, for CGT purposes, as the corresponding Transerv share (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case whether or not the demerger roll-over is chosen.

Demerger roll-over

38. Transerv and TSV Montney were part of a demerger group (subsection 125-65(1) of the ITAA 1997).

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

40. Accordingly, Transerv shareholders can choose demerger roll-over under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing demerger roll-over

41. A Transerv shareholder who chooses demerger roll-over:
- will disregard any capital gain made when CGT event G1 happened to each of their Transerv shares under the demerger (subsection 125-80(1) of the ITAA 1997)

- must calculate the first element of the cost base and reduced cost base of their new TSV Montney shares (paragraph 125-80(2)(a) of the ITAA 1997), and
- must recalculate the first element of the cost base and reduced cost base of their remaining Transerv shares (paragraph 125-80(2)(b) of the ITAA 1997).

42. The first element of the cost base and reduced cost base of each Transerv share and corresponding TSV Montney share received under the demerger is worked out by:

- taking the sum of the cost bases of the Transerv shares (just before the demerger), and
- apportioning that sum over the Transerv shares and corresponding new TSV Montney shares acquired under the demerger.

43. This apportionment of the sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Transerv shares and TSV Montney shares or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

44. The Commissioner accepts that a reasonable apportionment of the summed cost base is to attribute:

- 75.84% of the summed cost base to the Transerv shares, and
- 24.16% of the summed cost base to the TSV Montney shares.

CGT consequences of not choosing demerger roll-over

45. A Transerv shareholder who does not choose demerger roll-over:

- is not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their Transerv shares under the demerger, and
- must:
 - calculate the first element of the cost base and reduced cost base of each corresponding TSV Montney share, and
 - recalculate the first element of the cost base and reduced cost base of each Transerv share

in the same way as described above in paragraphs 41 to 44 of this Ruling (section 125-85 of the ITAA 1997).

Dividend consequences

46. No part of the distribution of TSV Montney shares to Transerv shareholders is a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

47. Accordingly, no part of the distribution of TSV Montney shares is included in the assessable income of Transerv shareholders under paragraph 44(1)(a) of the ITAA 1936.

Application of section 45

48. Section 45 of the ITAA 1936 will not apply to treat the value of the TSV Montney shares received by Transerv shareholders under the demerger as a dividend paid by Transerv that is unfrankable.

Application of section 45A

49. The Commissioner will not make a determination under paragraph 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit provided to Transerv shareholders under the demerger.

Application of section 45B

50. 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 Transerv shareholders under the demerger.

51. 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 Transerv shareholders under the demerger.

Commissioner of Taxation

11 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 event G1

52. Under the scheme, CGT event G1 happened. The Ruling section provides a detailed explanation of the Commissioner's decision. Therefore, no further explanation is warranted.

Demerger roll-over

53. Subsection 125-80(1) of the ITAA 1997 enables a shareholder to choose demerger roll-over. If a demerger roll-over is chosen then 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 is disregarded.

54. Subsection 125-55(1) of the ITAA 1997 provides that an entity may, at the time of the demerger, choose to obtain a roll-over if:

- the entity owns a share in the company (the original interest)
- the company is the head entity of a demerger group
- a demerger happens to the demerger group, and
- under the demerger, a CGT event happens to the original interest and the entity acquires a new or replacement interest (the new interest) in the demerged entity.

55. The conditions for choosing demerger roll-over under Division 125 of the ITAA 1997 were satisfied in respect of the demerger. Accordingly, the demerger concessions in Division 125 are available to Transerv shareholders.

Dividend consequences

56. Paragraph 44(1)(a) of the ITAA 1936 operates to include in a shareholder's assessable income any dividends, as defined in subsection 6(1) of the ITAA 1936, paid to the shareholder out of profits derived by the company from any source (if the shareholder is an Australian resident).

57. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes any distribution made by a company to any of its shareholders whether in money or other property.

58. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes amounts of moneys paid or credited, or the amount of the value of the property, debited against an amount standing to the credit of the share capital account of the company.

59. The term 'share capital account' is defined in subsection 975-300(1) of the ITAA 1997 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.

60. However, an account is not a share capital account if it is tainted (subsection 975-300(3) of the ITAA 1997).

61. A share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the share capital account where the account is not already tainted (section 197-50 of the ITAA 1997).

62. Transerv has stated that its share capital account remains untainted.

63. The demerger of TSV Montney was implemented by Transerv distributing property (TSV Montney shares) to shareholders of Transerv. The total market value of the TSV Montney shares distributed to the shareholders of Transerv was debited against an amount standing to the credit of Transerv's share capital account.

64. As Transerv's share capital account is not tainted, within the meaning of Division 197 of the ITAA 1997, the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies.

65. Accordingly, the distribution will not be included in the assessable income of a Transerv shareholder under subsection 44(1) of the ITAA 1936.

Section 45

66. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders (paragraphs 45(1)(a) and 45(1)(b) of the ITAA 1936). Minimally franked dividends are dividends which are franked to less than 10% (subsection 45(3) of the ITAA 1936).

67. The demerger resulted in all holders of Transerv shares receiving a proportionate number of shares in TSV Montney.

68. Under the demerger, no dividends were declared or paid.

69. Therefore, neither paragraph 45(1)(a) of the ITAA 1936 nor paragraph 45(1)(b) of the ITAA 1936 will apply to the demerger.

70. Accordingly, section 45 of the ITAA 1936 does not apply to treat the value of the TSV Montney shares received by Transerv shareholders under the demerger as a dividend that is unfrankable.

Section 45A

71. Section 45A of the ITAA 1936 applies in certain circumstances where a company streams capital benefits and the payment of dividends to shareholders in such a way that capital benefits are provided to shareholders who would derive a greater benefit from the capital benefit than other shareholders, with it being reasonable to assume that the other shareholders have received, or will receive, dividends.

72. The Commissioner may make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

73. The distribution provided by Transerv to its shareholders, under the demerger, was sourced from its share capital account and therefore constitutes the provision of a capital benefit. However, the capital benefit was provided to all Transerv shareholders in the same proportion as their shareholdings.

74. Transerv did not discriminate between Transerv shareholders in the implementation of the demerger and the transaction took one form for all shareholders.

75. There is no evidence to indicate the 'streaming' of capital benefits to some shareholders and dividends to other shareholders.

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

Section 45B

77. The purpose of section 45B of the ITAA 1936 is to ensure that relevant amounts distributed to shareholders of a company are treated as dividends for tax purposes if:

- components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger, or
- certain payments, allocations and distributions are made in substitution for dividends (subsection 45B(1) of the ITAA 1936).

78. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, the Commissioner may, where applicable, make a determination that the amount of the demerger benefit, or part, of the demerger benefit is taken not to be a demerger dividend (subsection 45BA(1) of the ITAA 1936) or the amount of the capital benefit, or part of the capital benefit, is to be treated as an unfranked dividend (subsection 45C(1) of the ITAA 1936).

79. The phrase 'provided with a demerger benefit' is defined in subsection 45B(4) of the ITAA 1936 and includes a company providing a person with ownership interests (such as shares) in that (or another) company.

80. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936 and includes provision of ownership interests (such as shares) in a company to a person.

81. The distribution of TSV Montney shares to the Transerv shareholders constitutes the provision of a demerger benefit and the provision of a capital benefit to the Transerv shareholders.

82. The Commissioner considers that, under the demerger, some of the Transerv shareholders obtained a tax benefit within the meaning of subsection 45B(9) of the ITAA 1936.

83. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, in relation to the demerger, the Commissioner is required to consider the relevant circumstances outlined in subsection 45B(8) of the ITAA 1936 to determine whether it could be concluded that entities that entered into or carried out the demerger (or any part of the demerger) did so for a purpose (other than an incidental purpose) of enabling Transerv shareholders to obtain a tax benefit.

84. Having regard to the relevant circumstances outlined in subsection 45B(8) of the ITAA 1936, the Commissioner has formed the view that the requisite purpose did not exist.

85. Accordingly, section 45B of the ITAA 1936 does not apply to the demerger and 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 Transerv shareholders under the demerger.

86. Similarly, as section 45B of the ITAA 1936 does not apply to the demerger, 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 Transerv shareholders under the demerger.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

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