

CR 2015/86 - Income tax: demerger of TMK Montney Ltd by Tamaska Oil & Gas Limited



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Class Ruling

Income tax: demerger of TMK Montney Ltd by Tamaska Oil & Gas 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, 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 Tamaska Oil & Gas Limited (Tamaska) 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 Tamaska on the Record Date of the scheme (8 October 2015)
- owned ordinary shares in Tamaska 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 Tamaska.

(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 'Tamaska 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 31 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 TMK Montney Ltd (TMK Montney) shares by Tamaska which occurred on 20 October 2015.

Relevant entities

Tamaska Oil & Gas Limited

11. Tamaska is an Australian resident public company incorporated on 26 September 2007 and listed on the Australian Securities Exchange (ASX) on 10 July 2008.

12. Tamaska is an oil and gas exploration company headquartered in Perth with major investments in the United States of America and Canada.

13. Just before the demerger, Tamaska had the following shares and options on issue:

- 714,000,000 fully paid ordinary shares
- 180,000,000 unlisted options.

14. There are no other ownership interests in Tamaska.

15. As at 30 June 2015, Tamaska had issued share capital of \$30,965,549 and Tamaska did not have positive retained earnings.

16. Tamaska has never paid any dividends since its incorporation.

TMK Montney

17. TMK Montney is an Australian resident company. TMK Montney was incorporated on 16 July 2015.

18. Just before the demerger:

- TMK Montney was wholly-owned by Tamaska
- Tamaska held all the TMK Montney shares on issue
- Tamaska owned shares in TMK Montney that carried between them the right to:
 - receive 100% of any distribution of income or capital by TMK Montney, and

- exercise, or control the exercise of, 100% of the voting power of TMK Montney,
- Tamaska held all the TMK Montney shares as a CGT asset on capital account, and
- there were no other ownership interests in TMK Montney, as defined in subsection 125-60(1) of the ITAA 1997.

The demerger

19. The demerger of TMK Montney occurred on the Implementation Date when Tamaska:

- undertook a capital reduction, returning 15.68% of the original capital contributed, and
- made an in specie distribution of all the shares in TMK Montney to holders of ordinary shares in Tamaska.

20. Tamaska shareholders received one TMK Montney share for every 10 Tamaska shares held on the Record Date.

21. Concurrently with the above, TMK Montney issued to existing Tamaska option holders one option in TMK Montney for every 10 Tamaska options held by the Tamaska option holder.

22. The TMK Montney options are exercisable at nine cents each on or before 31 March 2019.

23. No other distribution was received by the Tamaska shareholders from Tamaska.

Reasons for the demerger

24. Tamaska's reasons for undertaking the demerger were as follows:

- The demerger will enable Tamaska 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 which ultimately constrain the amount of capital each project may attract on a standalone basis.
- Demerging TMK Montney would, as a dedicated corporate vehicle, more likely attract private funding that it needs to take the project through to development.
- TMK 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 of the MJV. Having a management team with the sole objective to develop TMK Montney's assets should lead the project to being executed in a more timely and efficient manner.

- Becoming an unlisted company will remove the projects continuous disclosure requirements under the ASX Listing Rules. This will allow TMK Montney to keep price sensitive drilling data confidential which will give TMK 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

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

Other matters

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

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

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

29. No Tamaska shareholder acquired their Tamaska shares before 20 September 1985.

30. No Tamaska shares were bought-back under the demerger.

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

Ruling**Capital gains tax (CGT)*****CGT event G1***

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

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

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

Acquisition date of TMK Montney shares

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

36. However, for the purposes of determining eligibility for a discount capital gain, a TMK Montney share received by a Tamaska shareholder under the demerger is taken to have been acquired on the same date, for CGT purposes, as the corresponding Tamaska 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

37. Tamaska and TMK Montney were part of a demerger group (subsection 125-65(1) of the ITAA 1997).

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

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

CGT consequences of choosing demerger roll-over

40. A Tamaska shareholder who chooses demerger roll-over:

- will disregard any capital gain made when CGT event G1 happened to each of their Tamaska 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 TMK 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 Tamaska shares (paragraph 125-80(2)(b) of the ITAA 1997).

41. The first element of the cost base and reduced cost base of each Tamaska share and corresponding TMK Montney share received under the demerger is worked out by:

- taking the sum of the cost bases of the Tamaska shares (just before the demerger), and

- apportioning that sum over the Tamaska shares and corresponding new TMK Montney shares acquired under the demerger.

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

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

- 37.04% of the summed cost base to the Tamaska shares, and
- 62.96% of the summed cost base to the TMK Montney shares.

CGT consequences of not choosing demerger roll-over

44. A Tamaska 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 Tamaska shares under the demerger, and
- must:
 - calculate the first element of the cost base and reduced cost base of each corresponding TMK Montney share, and
 - recalculate the first element of the cost base and reduced cost base of each Tamaska share
 in the same way as described in paragraphs 40 to 43 of this Ruling (section 125-85 of the ITAA 1997).

Dividend consequences

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

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

Application of section 45

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

Application of section 45A

48. 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 Tamaska shareholders under the demerger.

Application of section 45B

49. 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 Tamaska shareholders under the demerger.

50. 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 Tamaska 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

51. 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

52. 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.

53. 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.

54. 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 Tamaska shareholders.

Dividend consequences

55. 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).

56. 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.

57. 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.

58. 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.

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

60. 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).

61. Tamaska has stated that its share capital account remains untainted.

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

63. As Tamaska'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.

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

Section 45

65. 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).

66. The demerger resulted in all holders of Tamaska shares receiving a proportionate number of shares in TMK Montney.

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

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

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

Section 45A

70. 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.

71. 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.

72. The distribution provided by Tamaska 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 Tamaska shareholders in the same proportion as their shareholdings.

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

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

75. 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

76. 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).

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

78. 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.

79. 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.

80. The distribution of TMK Montney shares to the Tamaska shareholders constitutes the provision of a demerger benefit and the provision of a capital benefit to the Tamaska shareholders.

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

82. 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 Tamaska shareholders to obtain a tax benefit.

83. 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.

84. 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 Tamaska shareholders under the demerger.

85. 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 Tamaska shareholders under the demerger.

Appendix 2 – Detailed contents list

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Not previously issued as a draft

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NO: 1-7ACZXRA

ISSN: 2205-5517

ATOlaw topic: Income tax ~~ Capital gains tax ~~ Restructures /
mergers and acquisitions / demergers

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