

ASX Announcement

Date: 3 April 2013



Talon Petroleum Limited

ABN 88 153 229 086

Level 9, 46 Edward Street
Brisbane, Qld Australia 4000

Postal: GPO Box 402
Brisbane, Qld Australia 4001

Telephone: +61 7 3211 1122
Fax: +61 7 3211 0133

Directors:

John Armstrong
Angus Douglas
Clifford S. Foss
David Mason

Company Secretary:

Des Olling

Contact:

Clifford Foss
President, CEO & Managing Director
cfoss@texozep.com

or:

John Armstrong
Chairman
john.armstrong@talonpetroleum.com.au

Website:

www.talonpetroleum.com.au

ASX Code: TPD

Demerger Class Ruling CR 2013/23

As part of the demerger of Talon Petroleum Limited (**Talon**) from Texon Petroleum Ltd (**Texon**), a ruling was sought from the Australian Taxation Office (**ATO**) on the taxation implications for shareholders.

The ATO has issued Class Ruling CR 2013/23 (**Ruling**), in accordance with that application made by Texon.

The Ruling contains details about the taxation treatment applicable to certain Texon shareholders who received Talon ordinary shares pursuant to the scheme of arrangement (**Demerger Scheme**) between Texon and its shareholders.

A copy of the Ruling is attached. The Ruling and further guidance on its application are available on the ATO website at <http://law.ato.gov.au/atolaw/view.htm?docid=CLR/CR201323/NAT/ATO/00001>

The Ruling means that, among other things, persons who were residents of Australia for income tax purposes on the record date for the Demerger Scheme, namely 6.00pm on 6 March 2013, and who held Texon shares on capital account will be able to choose demerger roll-over relief in relation to the Demerger Scheme for their Texon shares.

Paragraphs 43 – 45 set out a basis for former Texon Shareholders who choose demerger relief to recalculate/calculate the cost basis and reduced cost basis of their Texon and new Talon Shares. In particular, it states that the ATO accepts that a reasonable apportionment of the summed cost base of the Texon shares prior to the demerger is:

- 84% of the summed cost base to the Texon shares; and
- 16% of the summed cost base to Talon shares.

The above does not take into account the individual circumstances of particular former Texon shareholders and does not constitute tax advice. Appropriate professional advice should be sought on the tax implications of the Demerger Scheme based on individual circumstances.

-ends



Class Ruling

Income tax: demerger of Talon Petroleum Limited by Texon Petroleum Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	9
Ruling	36
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	54
Appendix 2:	
Detailed contents list	74

ⓘ 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 provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 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 consists of the ordinary shareholders of Texon Petroleum Limited (Texon) who:

- (a) were listed on the share register of Texon as at the Record Date (6 March 2013);
- (b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date;
- (c) held their Texon shares on capital account on the Record Date; and
- (d) 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 Texon shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

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

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 9 to 35 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.

7. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Copyright and Classification Policy Branch
Attorney-General's Department
3-5 National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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. On 13 November 2012, Texon announced to the Australian Securities Exchange (ASX) its intention to merge with Sundance Energy Australia Limited (Sundance) by way of a Scheme of Arrangement.

11. A condition precedent of this merger was that Texon was required to divest itself of its non-Eagle Ford assets held by its 100% owned subsidiary Talon Petroleum Limited (Talon).

12. The effect of the demerger was to create two separate companies with:

- Texon's interests in the Eagle Ford Shale Project (the Eagle Ford Business) held by Texon (through its 100% owned subsidiaries); and

- the non-Eagle Ford assets held by Talon (previously known as Texon III Limited).

13. The demerger was approved by the shareholders of Texon at the demerger scheme meeting held on 25 February 2013. The demerger was implemented on 7 March 2013 (the Implementation Date).

Relevant entities

Texon Petroleum Limited

14. Texon is an Australian resident company incorporated in 2006 and was listed on the ASX. Texon was a 'listed public company' (as that term is defined in subsection 995-1(1) of the ITAA 1997) and the head company of a tax consolidated group for the purposes of Part 3-90 of the ITAA 1997.

15. Texon is an Australian based oil and gas explorer and producer with operations located in South Texas in the United States of America (USA).

16. Texon's core business was the development of the Eagle Ford Business which is an oil/natural gas condensate reservoir located in Texas, USA.

17. Texon also operated the non-Eagle Ford Business held by its 100% owned subsidiary Talon. The non-Eagle Ford Business consists of two producing wells and includes exploration and evaluation activities to identify potential projects that allow for multi-well drilling programs.

18. As at 20 September 2012 Texon had on issue:

- 245,039,848 ordinary shares; and
- 17,800,000 unlisted options.

19. Immediately prior to the demerger Texon had no options on issue.

20. There were no other ownership interests in Texon just before the demerger.

Talon Petroleum Limited

21. Texon III Limited was incorporated in Australia on 14 September 2011 as a public company limited by shares.

22. Texon III Limited changed its name to Talon Petroleum Limited on 26 November 2012.

23. Talon's business focus is on the continued development of the non-Eagle Ford Business.

24. Immediately prior to the demerger Texon held 100% of the ordinary shares on issue in Talon.

Pre-demerger transactions

25. Prior to the demerger, Texon transferred to Talon (or one of its 100% owned subsidiaries) certain administrative assets to facilitate the demerger.

26. Texon had provided funding to Talon by way of inter-company loans, with the inter-company balance standing at approximately \$31.5 million as at the Record Date. This balance was converted into equity, immediately prior to the demerger, resulting in the issue of approximately 98.2 million Talon shares to Texon.

The demerger

27. The demerger of Talon was carried out by a capital reduction and a court approved Scheme of Arrangement, both of which were approved by the requisite majority of Texon shareholders on 25 February 2013.

28. On the Implementation Date, Texon reduced its share capital in the amount of \$19.22 million in aggregate which was applied equally against each ordinary share of the Company on issue as at the Record Date.

29. In accordance with the terms of the Scheme of Arrangement, Texon shareholders were entitled to two Talon shares for every five shares they owned in Texon as at 6pm Australian Eastern Standard Time on the Record Date

Ineligible foreign shareholders

30. Talon shares were not issued to certain shareholders of Texon whose address was in a place outside Australia (ineligible foreign shareholders). The Talon shares to which the ineligible foreign shareholders would have been entitled were instead sold through a share sale facility with the net proceeds paid to the relevant Texon shareholder.

Reasons for the demerger

31. Texon considered the main advantages of the demerger to be:

- independence in the strategic, operational and investment decisions that are relevant to each business;
- the ability to independently access capital to pursue separate opportunities;
- greater investor choice as the growth and risk profile of exploration and early stage resource projects are different from more developed projects; and

- to facilitate the merger with Sundance which had a requirement that all non-Eagle Ford Business assets be divested prior to the merger.

Other Matters

32. Talon commenced trading on the ASX on 28 February 2013 on a deferred settlement basis.

33. Just after the demerger of Talon, at least 50% of the market value of capital gains tax (CGT) assets owned by Talon or its subsidiaries were used in carrying on a business by those entities.

34. Texon confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997.

35. Texon has never paid a dividend to its shareholders.

Ruling

CGT consequences

CGT event G1

36. CGT event G1 happened in relation to each Texon share owned by a Texon shareholder at the time Texon made the payment of the capital reduction amount (section 104-135 of the ITAA 1997).

37. A Texon shareholder made a capital gain when CGT event G1 happened if the market value of the capital reduction amount received for each Texon share exceeded the cost base of that share. The capital gain is equal to the amount of the excess (subsection 104-135(3) of the ITAA 1997). No capital loss can be made when CGT event G1 happens.

Demerger roll-over

38. Texon and its subsidiary Talon were part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

40. A Texon shareholder can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their Texon shares.

CGT consequences of choosing roll-over

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

Other consequences of choosing roll-over

42. A Texon shareholder who chooses demerger roll-over relief must also recalculate the cost base and reduced cost base of their Texon shares and calculate the cost base and reduced cost base of their new Talon shares.

43. The first element of the cost base and reduced cost base of each Texon share and corresponding Talon share received under the demerger is worked out as follows:

- sum the cost bases of the Texon shares (just before the demerger); and
- apportion that sum over the Texon shares and corresponding new Talon shares received under the demerger.

44. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Texon shares and Talon shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

45. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3) of the ITAA 1997, the Commissioner accepts that a reasonable apportionment of the summed cost base is to:

- attribute 84% of the summed cost base to the Texon shares; and
- attribute 16% of the summed cost base to the Talon shares.

Texon shareholders who do not choose roll-over

46. A Texon shareholder who does not choose demerger roll-over relief:

- is not entitled to disregard any capital gain made when CGT event G1 happened to their Texon shares under the demerger; and
- the first element of the cost base and reduced cost base of each Texon share and corresponding Talon share is calculated in the manner described in paragraphs 43 and 45 of this Ruling (section 125-85 of the ITAA 1997).

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

47. For the purpose of determining eligibility for a discount capital gain, the Talon shares received by a Texon shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding Texon shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case whether demerger roll-over relief is chosen or not.

Dividend consequences

Demerger dividend

48. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).

49. Any demerger dividend is neither assessable income nor exempt income of a Texon shareholder (subsections 44(3) and 44(4) of the ITAA 1936).

50. As the share capital reduction amount was debited to Texon's share capital account, it is not 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 contained in subsection 6(1)).

The application of sections 45, 45A, 45B, 45BA and 45C of the ITAA 1936

51. Section 45 and section 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to Texon shareholders under the demerger.

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 Texon 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 Texon 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 consequences

54. The CGT 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.

55. A significant tax consequence is the availability of demerger roll-over relief in Division 125 of the ITAA 1997 which enables Texon shareholders to disregard a capital gain made under the demerger.

56. There are special rules for calculating the cost base and reduced cost base of the Texon and Talon shares whether or not roll-over is chosen.

Conditions for demerger roll-over

57. 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 are:

- (a) a shareholder owns a share in a company;
- (b) the company is the head entity of a demerger group;
- (c) a demerger happens to the demerger group; and
- (d) under the demerger, a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity and nothing else.

58. 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 section of this document is necessary.

Demerger dividend

59. Subsection 44(1) of the ITAA 1936 operates to include in a shareholder's assessable income any dividend, within the meaning of that term in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

60. Paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 provides that a dividend excludes amounts debited against an amount standing to the credit of the share capital account of the company.

61. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account that 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.

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

63. In the circumstances of this demerger, Texon debited the capital reduction amount to its 'share capital account' (as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997). This amount is therefore not a dividend for the purposes of subsection 6(1) of the ITAA 1936 and is not assessable as a dividend under subsection 44(1) of the ITAA 1936.

The application of sections 45, 45A, 45B, 45BA and 45C of the ITAA 1936

Section 45 of the ITAA 1936

64. 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. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

65. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to the whole or any part of any demerger benefit received by Texon shareholders.

Section 45A of the ITAA 1936

66. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

67. Where the Commissioner makes a written determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole or part of the capital benefits, the capital benefits will be treated as unfranked dividends paid out of the company's profits.

68. Based on the information provided and having regard to the circumstances of the scheme, section 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to Texon shareholders and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies.

Section 45B of the ITAA 1936

69. 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 (subsection 45B(1) of the ITAA 1936).

70. Subsection 45B(2) of the ITAA 1936 provides (relevantly) that the section applies if:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company;
- (b) under the scheme the taxpayer obtains a tax benefit as defined in subsection 45B(9) of the ITAA 1936; and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling the taxpayer to obtain the tax benefit.

71. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) 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.

72. 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 Texon shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

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

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provisions	2
Class of entities	3
Qualifications	4
Date of effect	8
Scheme	9
Background	10
Relevant entities	14
<i>Texon Petroleum Limited</i>	14
<i>Talon Petroleum Limited</i>	21
Pre-demerger transactions	25
The demerger	27
<i>Ineligible foreign shareholders</i>	30
Reasons for the demerger	31
Other matters	32
Ruling	36
CGT consequences	36
<i>CGT event G1</i>	36
<i>Demerger roll-over</i>	38
<i>CGT consequences of choosing roll-over</i>	41
<i>Other consequences of choosing roll-over</i>	42
<i>Texon shareholders who do not choose roll-over</i>	46
<i>Acquisition date of the Talon shares for the purposes of the CGT discount</i>	47
Dividend consequences	48
<i>Demerger dividend</i>	48
The application of sections 45, 45A, 45B, 45BA and 45C of the ITAA 1936	51
Appendix 1 – Explanation	54
CGT consequences	54
Conditions for demerger roll-over	57
Demerger dividend	59

The application of sections 45, 45A, 45B, 45BA and 45C of the ITAA 1936	64
<i>Section 45 of the ITAA 1936</i>	64
<i>Section 45A of the ITAA 1936</i>	66
<i>Section 45B of the ITAA 1936</i>	69
Appendix 2 – Detailed contents list	74

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT events G1–G3 – shares
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary
- return of capital on shares

- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(9)
- ITAA 1936 45B(3)(a)
- ITAA 1936 45B(3)(b)
- ITAA 1936 45BA
- ITAA 1936 45C
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 115-30
- ITAA 1997 115-30(1)
- ITAA 1997 Div 125
- ITAA 1997 125-55
- ITAA 1997 125-55(1)
- ITAA 1997 125-65(1)
- ITAA 1997 125-70
- ITAA 1997 125-80(1)
- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
- ITAA 1997 125-85
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 Pt 3-90
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1(1)
- TAA 1953
- Copyright Act 1968

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45B
- ITAA 1936 45B(1)
- ITAA 1936 45B(2)

ATO references

NO: 1-4E8VK8S

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to
G3 – shares
Income Tax ~~ Capital Gains Tax ~~ roll-overs – other
Income Tax ~~ Capital Gains Tax ~~ demerger relief