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Class Ruling

Oil Search Limited – scheme of arrangement and scrip for scrip roll-over

❶ Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

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What this Ruling is about

1. This Ruling sets out the income tax consequences for shareholders of Oil Search Limited (OSH) who disposed of their OSH shares to Santos Limited (STO) on 17 December 2021 (Implementation Date) by way of a scheme of arrangement (Scheme).
2. Full details of this scheme are set out in paragraphs 23 to 53 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you:
 - were a holder of ordinary shares in OSH who disposed of your OSH shares to STO on the Implementation Date under the Scheme
 - were registered on the OSH share register on 14 December 2021 (Record Date)
 - are an Australian resident as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) or a non-resident (other than a

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non-resident who carries on a business at or through a permanent establishment¹ in Australia)

- held those shares on capital account; that is, you did not hold your shares in OSH as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 955-1(1)), and
- acquired your OSH shares on or after 20 September 1985.

5. This Ruling does not apply to you if you:

- acquired your OSH shares under an OSH employee share plan (ESS) and your deferred taxing point occurred on the Implementation Date
- are subject to the investment manager regime in Subdivision 842-I in relation to your OSH shares, or
- are subject to the taxation of financial arrangements rules in Division 230 in relation to your OSH shares.

Note: Division 230 will not apply to individuals unless they have made an election for it to apply.

When this Ruling applies

6. This Ruling applies from 1 July 2021 to 30 June 2022.

Ruling

Capital gains tax consequences

CGT event A1

7. CGT event A1 happened when you disposed of each of your OSH shares to STO in accordance with the Scheme (subsection 104-10(1)).

8. The time of CGT event A1 was when the OSH shares were transferred to STO on the Implementation Date (paragraph 104-10(3)(b)).²

9. You made a capital gain from CGT event A1 happening if the capital proceeds from the disposal of your OSH shares exceeds the cost base of that share. You made a capital loss if the capital proceeds were less than the reduced cost base of your OSH shares (subsection 104-10(4)).

Non-resident shareholders

10. If you were a non-resident shareholder just before CGT event A1 happened to your OSH shares on 17 December 2021, you disregard any capital gain or capital loss made as a result of CGT event A1 happening, as your OSH shares were not taxable Australian property for the purposes of section 855-10.

¹ The term 'permanent establishment' is defined in the relevant international tax treaty, if there is one, or if not, as defined in subsection 6(1) of the ITAA 1936.

² See paragraph 9 of Taxation Determination TD 2002/4 *Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?*

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Capital proceeds – cash consideration for Oil Search Limited shares

11. The capital proceeds received from CGT event A1 for the disposal of OSH shares for which the cash payment was received (Cash Consideration) is the amount of that Cash Consideration, being \$4.0618 per OSH share disposed of (paragraph 116-20(1)(a)).

Capital proceeds – scrip consideration for Oil Search Limited shares

12. The capital proceeds received from CGT event A1 for the disposal of OSH shares that were replaced with STO shares is the total market value (worked out at the time of the CGT event A1) of the replacement new STO shares you received under the Scheme (Scrip Consideration) divided by the number of OSH shares you disposed of (paragraph 116-20(1)(b)).

13. For the purposes of determining the market value of an STO share for the capital proceeds as required by subsection 104-10(4), the Commissioner accepts that the market value of an STO share on the Implementation Date was \$6.4881.

Scrip for scrip roll-over under Subdivision 124-M availability

14. Subject to the qualification in paragraph 15 of this Ruling, if you have made a capital gain from the disposal of OSH shares for which you received Scrip Consideration, you may choose scrip for scrip roll-over (section 124-780).

15. Scrip for scrip roll-over cannot be chosen if any capital gain that you might make from the replacement new STO shares would be disregarded other than because of a roll-over (for example, if the shares were your trading stock) (subsection 124-795(2)).

Consequences if you choose to apply scrip for scrip roll-over

16. Where scrip for scrip roll-over is available to you (see paragraphs 14 and 15 of this Ruling) and you choose to apply it, the capital gain in relation to the receipt of STO shares is disregarded (subsection 124-785(1)).

17. The first element of the cost base and reduced cost base of a replacement STO share received (in exchange for your original OSH shares) is worked out by reasonably attributing the cost base and reduced cost base (respectively) of your original OSH shares (subsections 124-785(2) and (4)). In this case, due to the 1:0.6275 exchange ratio, the cost base of an OSH share is divided by 0.6275 to determine the cost base of each replacement new STO share.

18. The date of acquisition of these STO shares for 'discount capital gain' purposes is the date you acquired your original OSH shares (table item 2(a) of subsection 115-30(1)).

Consequences if scrip for scrip roll-over is not chosen, or cannot be chosen

19. If you do not choose, or cannot choose, scrip for scrip roll-over, you must take into account any capital gain or capital loss from CGT event A1 happening on the disposal of your OSH shares in working out your net capital gain or net capital loss for the income year in which CGT event A1 happened (sections 102-5 and 102-10).

20. If you make a capital gain where roll-over is not chosen, or cannot be chosen, you can treat the capital gain as a 'discount capital gain' provided that the conditions of

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Subdivision 115-A are met. In particular, the OSH shares that you disposed of must have been acquired by you at least 12 months before their disposal to STO (section 115-25).

21. The first element of the cost base and reduced cost base of a replacement new STO share received is equal to the market value of the OSH shares given in respect of acquiring the STO share (subsections 110-25(2) and 110-55(2)). The market value of the OSH shares is worked out as at the time of the acquisition of the replacement new STO shares, which is on the Implementation Date (subsection 110-25(2)).

22. The date of acquisition of the replacement STO shares is the date you were issued these shares (table item 2 of section 109-10). That is, the Implementation Date of the Scheme, being 17 December 2021.

Scheme

23. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

Oil Search Limited

24. OSH was established in 1929 in Papua New Guinea (PNG) and, prior to the Implementation Date, was listed on the Australian Securities Exchange (ASX) and PNG's National Stock Exchange (PNGX). OSH was an oil and gas exploration and development company.

25. OSH was not an Australian-resident company.

26. OSH had one class of ordinary shares. There were 2,077,850,664 OSH shares on issue on the Record Date.

27. Subject to the Scheme becoming effective, the non-executive director restricted shares and OSH restricted shares had any restrictions on their disposal released on 9 December 2021 and the holders of those interests were eligible to participate in the Scheme as OSH shareholders.

28. The following actions were taken in relation to the OSH Equity Incentives on 10 December 2021:

- 347,578 OSH Alignment Rights vested in full and were cash settled
- 6,366,845 OSH Share Rights were cash settled, and
- 920,110 of the 4,710,986 OSH Performance Rights vested and were cash settled, and the remainder lapsed and were cancelled for no consideration.

Oil Search Limited shares held as American Depositary Receipts

29. OSH had a sponsored American Depositary Receipts (ADRs) program in place.

30. The OSH shares underlying each OSH ADR were eligible to participate in the Scheme on the same basis as other OSH shares.

31. Once the Scheme was implemented, following receipt of the Scheme Consideration, the ADR program sponsor sold the replacement new STO shares and distributed the proceeds to the OSH ADR holders in proportion to the number of OSH

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ADRs held by them. The OSH ADR program was then terminated on the earlier of 90 days after the date of the notice or the date on which there were no ADR's outstanding.

Santos Limited

- 32. STO is an Australian-incorporated company that was listed on the ASX.
- 33. STO is an oil and gas company.

Scheme of Arrangement

- 34. OSH and STO signed a Merger Implementation Deed (MID) on 10 September 2021. The merger was to be effected by a Scheme of Arrangement under PNG law whereby STO would acquire all of the shares in OSH.
- 35. Upon approval and implementation of the Scheme, OSH shareholders (other than Ineligible Foreign Shareholders, or Unmarketable Parcel Shareholders who did not opt-in to receive replacement new STO shares), would receive 0.6275 replacement new STO shares for each OSH share they owned as at the Record Date (Scrip Consideration).
- 36. All new STO shares issued to OSH Shareholders under the Scheme would rank equally in all respects with all existing STO shares on issue as at the Implementation Date.
- 37. Ineligible Foreign Shareholders, and Unmarketable Parcel Shareholders who did not opt-in to receive replacement new STO shares, would receive Cash Consideration on the disposal of their OSH shares as outlined in paragraphs 38 to 50 of this Ruling.
- 38. An Ineligible Foreign Shareholder was an OSH shareholder whose address as shown in the OSH Register was a place outside Australia and its external territories, New Zealand, PNG and the United States of America (unless otherwise agreed by the parties in writing, acting reasonably) or any other jurisdictions agreed by the parties in writing (each acting reasonably).
- 39. On the Implementation Date, STO issued the replacement new STO shares that would otherwise have been issued to an Ineligible Foreign Shareholder to a nominee appointed by STO to be sold.
- 40. For Ineligible Foreign Shareholders, the net cash proceeds of the sale of the replacement new STO shares to which they would have been entitled were paid to those Ineligible Foreign Shareholders on a pro rata basis.
- 41. An Unmarketable Parcel Shareholder was an OSH shareholder (other than an Ineligible Foreign Shareholder) who, based on their holding of OSH shares on the Record Date, was, on implementation, entitled to receive less than a marketable parcel (as that term is defined in the ASX Listing Rules) of replacement new STO shares (assessed by reference to the price of STO shares on the ASX as at the close of trade on the trading day prior to the Record Date) as Scheme Consideration.
- 42. An Unmarketable Parcel Shareholder could 'opt-in' to the Scheme and elect to receive the Scheme Consideration as replacement new STO shares by providing OSH with a duly completed Opt-in Notice prior to the Opt-in Notice Date (6:00 pm (Sydney) / 5:00 pm (Port Moresby) time on Monday 13 December 2021).
- 43. On the Implementation Date, STO was under no obligation to issue any replacement new STO shares to any Unmarketable Parcel Shareholder who did not opt-in to receive new STO shares.

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44. Where an Unmarketable Parcel Shareholder did not opt-In, STO issued the replacement new STO shares that would otherwise have been issued to such Unmarketable Parcel Shareholders to the Sale Agent to be sold, which was the same treatment as Ineligible Foreign Shareholders.
45. STO did not make a choice to deny roll-over under Subdivision 124-M (subsection 124-795(4)).
46. On 7 December 2021, the requisite majority of OSH shareholders approved the Scheme at the Scheme Meeting.
47. On 9 December 2021, the Scheme was approved by the PNG Court and it was announced on the ASX and PNGX that OSH shares would be suspended from the close of trading on 10 December 2021.
48. Ineligible Foreign Shareholders and Unmarketable Parcel Shareholders that received Cash Consideration held 0.04 % of OSH shares on the Record Date.
49. On 17 December 2021, OSH shareholders disposed of each share held in OSH to STO.
50. OSH applied to the ASX and PNGX to have quotation of its shares terminated and for OSH to be removed from the official list of the ASX and PNGX with effect from close of trading on 20 December 2021.

Other matters

51. Less than 50% of the total market value of assets held by OSH was 'taxable Australian real property' as defined in section 855-20.
52. This Ruling is made on the basis that OSH did not have a 'significant stakeholder' or 'common stakeholder' in relation to the Scheme (within the meaning of those expressions in section 124-783).

Timetable

53. The following table is a summary of the key dates for the scheme of arrangement:

Date	Event
10 September 2021	MID executed by OSH and STO
6 October 2021	File originating documents with PNG Court
11 November 2021	File Scheme Booklet with the PNG Court
15 November 2021	Despatch Scheme Booklet to OSH shareholders
7 December 2021	Scheme meeting
9 December 2021	Second Court date
10 December 2021	Effective Date
14 December 2021	Record Date
17 December 2021	Implementation Date

Commissioner of Taxation
15 June 2022

Appendix – Explanation

❶ *This Explanation 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.*

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Non-resident scheme shareholders

54. Under subsection 855-10(1), an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

55. The term 'taxable Australian property' is defined in the table in section 855-15. The following table sets out the 5 categories of CGT assets:

Item 1	Taxable Australian real property (TARP)
Item 2	An indirect Australian real property interest (see section 855-25) not covered by table item 5
Item 3	A CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by table items 1, 2 or 5
Item 4	An option or right to acquire a CGT asset covered by table items 1, 2 or 5
Item 5	A CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident)

56. Subsection 855-25(1) provides that a membership interest held by an entity in another entity at a time, is an indirect Australian real property interest at that time if the interest satisfies both the:

- non-portfolio interest test in section 960-195 at either time specified in subparagraphs 855-25(1)(a)(i) or (ii), and
- principal asset test in section 855-30 at that time.

57. Subsection 855-30(2) provides that a membership interest held by the holding entity in the test entity passes the principal asset test if the sum of the market values of the test entity's assets that are TARP assets exceeds the sum of the market values of its assets that are non-TARP assets.

58. The market value of OSH's TARP assets did not exceed the market value of its non-TARP assets. Therefore, the principal asset test is not satisfied.

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59. Any OSH shareholder that satisfies the non-portfolio interest test in section 960-195 at either time specified in subparagraphs 855-25(1)(a)(i) or (ii) does not have an indirect Australian real property interest because the principal asset test is not satisfied. Therefore, any capital gain or capital loss made when CGT event A1 happened by OSH shareholders that satisfy the non-portfolio interest test can be disregarded.

60. Accordingly, a capital gain that a non-resident OSH shareholder derived from CGT event A1 happening on disposal of their OSH shares to STO will be disregarded.

Availability of scrip for scrip roll-over if a capital gain is made

61. One consequence identified in this Ruling is the availability of scrip for scrip roll-over under Subdivision 124-M. The roll-over enables a shareholder to disregard a capital gain from a share that is disposed of if the shareholder receives a replacement share in exchange. It also provides special rules for calculating the cost base and reduced cost base of the replacement share.

62. Subdivision 124-M contains a number of conditions for, and exceptions to, a shareholder being eligible to choose scrip for scrip roll-over. The main requirements that needed to be satisfied for the Scheme are set out in section 124-780, namely:

- an entity exchanges shares in a company for shares in another company
- the exchange is in consequence of a single arrangement that satisfies subsections 124-780(2) or (2A)
- conditions for the roll-over are satisfied
- further conditions, if applicable, are satisfied, and
- exceptions to obtaining scrip for scrip roll-over are not applicable.

63. The Scheme satisfies the requirements for roll-over under Subdivision 124-M.

64. Subdivision 124-M contains a number of conditions for a shareholder being able to choose scrip for scrip roll-over and sets out certain exceptions. The requirements that are relevant to the scheme that is the subject of this Ruling were satisfied as:

- OSH shareholders exchanged their shares in OSH for shares in STO (paragraph 124-780(1)(a) and subparagraph 124-780(3)(c)(ii))
- the exchange was a consequence of a single arrangement that satisfies subsection 124-780(2) or (2A))
- neither STO nor any of its wholly-owned subsidiaries issued equity, apart from the STO shares issued to OSH shareholders in exchange for their OSH shares, or owed new debt under the arrangement in relation to the issue of those STO shares, to an entity that was not a member of the group (paragraph 124-780(3)(f))
- OSH shareholders dealt with STO at arm's length (subsection 124-780(4)), and
- STO did not make a choice under subsection 124-795(4) that OSH shareholders could not obtain the roll-over.

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References

Related Rulings/Determinations:

TD 2002/4

Legislative references:

- ITAA 1997 102-5
- ITAA 1997 102-10
- ITAA 1997 104-10(4)
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(3)(b)
- ITAA 1997 104-10(4)
- ITAA 1997 109-10
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(2)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25
- ITAA 1997 115-30(1)
- ITAA 1997 116-20(1)(a)
- ITAA 1997 116-20(1)(b)
- ITAA 1997 Subdiv 124-M
- ITAA 1997 124-780
- ITAA 1997 124-780(1)(a)
- ITAA 1997 124-780(2)
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- ITAA 1997 124-780(3)(c)(ii)
- ITAA 1997 124-780(3)(f)
- ITAA 1997 124-780(4)
- ITAA 1997 124-783
- ITAA 1997 124-785(1)
- ITAA 1997 124-785(2)
- ITAA 1997 124-785(4)
- ITAA 1997 124-795(2)
- ITAA 1997 124-795(4)
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-10(1)
- ITAA 1997 855-15
- ITAA 1997 855-20
- ITAA 1997 855-25(1)
- ITAA 1997 855-25(1)(a)(i)
- ITAA 1997 855-25(1)(a)(ii)
- ITAA 1997 855-30
- ITAA 1997 855-30(2)
- ITAA 1997 Subdiv 842-I
- ITAA 1997 977-50
- ITAA 1997 995-1(1)
- ITAA 1936 6(1)

ATO references

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