


# ***CR 2012/41 - Income tax: demerger of Phillips 66 by ConocoPhillips Company***

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## Class Ruling

### Income tax: demerger of Phillips 66 by ConocoPhillips Company

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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

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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 provision(s)**

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45BA of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 115-30 of the ITAA 1997;
- Division 125 of the ITAA 1997; and

- section 975-300 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

## **Class of entities**

3. The class of entities to which this Ruling applies are all Australian resident holders of ordinary shares in ConocoPhillips Company (COPCo) who:

- (a) were recorded on the share register of COPCo as at 1 May 2012 (the Record Date for the demerger of Phillips 66);
- (b) held their COPCo shares on capital account on the Record Date; and
- (c) were not subject to the Taxation of Financial Arrangement (TOFA) rules in Division 230 in relation to gains and losses on their COPCo 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.)

4. In this Ruling, a person belonging to the class of entities is referred to as a 'COPCo 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 10 to 30 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.

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## Date of effect

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9. This Ruling applies from 1 July 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 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

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10. 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

11. The scheme that is the subject of this Ruling involves the demerger by COPCo of Phillips 66.

### Reasons for the demerger

12. COPCo's purposes in undertaking the demerger are:
- to improve strategic and management 'fit and focus';
  - to provide each business with more attractive 'acquisition currency' and equity-based compensation;
  - to eliminate internal competition for capital; and
  - to enhance the ability of each business to attract and retain employees.

## **ConocoPhillips**

13. COPCo is a United States of America (USA) based company listed on the New York Stock Exchange (NYSE), and is a leading producer and marketer of natural gas.

14. COPCo's main business activities include:

- petroleum exploration and production;
- refining and marketing;
- natural gas gathering, processing and marketing; and
- chemicals and plastics production and distribution.

15. As at 31 December 2011, COPCo had 1,285,670,000 shares on issue with a share capitalisation of \$USD 93,686,772,900. Of these shares, approximately 330,000 shares are held in the Australian employee share scheme (Australian Plan).

16. The COPCo shares held in the Australian Plan represent less than 3% of the ownership rights in COPCo having regard to the number and value. These interests satisfy the requirements of an employee share scheme for the purposes of Division 83A and are not fully paid ordinary shares.

## **COP Australia**

17. ConocoPhillips Australia Pty Ltd and ConocoPhillips (03-12) Pty Ltd (collectively COP Australia) are wholly owned subsidiaries of COPCo. COP Australia undertakes exploration and production of oil and gas, with assets and exploration activities in the Timor Sea, Northern Territory, Western Australia and Timor-Leste.

18. COP Australia employs approximately 600 employees, all of whom are offered participation in various employee share plans as part of COP Australia's long term incentive plans.

## **Phillips 66**

19. Immediately prior to the demerger, Phillips 66 was a wholly owned subsidiary of COPCo.

20. At the time of the demerger, Phillips 66 was a USA resident company.

**Pre-demerger transactions**

21. Prior to the demerger, members of the COPCo group of companies undertook a number of transactions to facilitate the demerger. These included an intra-group transfer of assets and liabilities to Phillips 66, including the subsidiaries responsible for COPCo's refining and marketing business; most of its natural gas gathering, processing and marketing business; its chemicals and plastics production and distribution business and other emerging businesses. Phillips 66 issued Phillips 66 shares to COPCo as consideration for the transfer of the businesses.

**The demerger**

22. At the time of the demerger, COPCo will distribute its ownership interests in Phillips 66 on a pro-rata basis to its shareholders as a reduction of capital.

23. COPCo shareholders will receive one Phillips 66 share for every two COPCo shares held at the time of the demerger. After the demerger the value of two COPCo shares plus one Phillips 66 share will be the same as the value of two COPCo shares immediately prior to the demerger. There will be no cash benefit paid to shareholders pursuant to the transaction.

24. As a result of the demerger, COPCo shareholders will own shares in both COPCo and Phillips 66.

25. COP Australia remains a wholly owned subsidiary of COPCo before and after the demerger.

**Accounting for the demerger transaction**

26. Under US GAAP, the broad accounting treatment for the distribution of Phillips 66 shares in COPCo will be:

|                      |              |
|----------------------|--------------|
| CR Assets            | \$43 billion |
| DR Liabilities       | \$20 billion |
| DR Retained Earnings | \$23 billion |

**Post-demerger**

27. Phillips 66 will be a stand-alone USA publically listed company.

**Other matters**

28. There was no off market buy-back of shares under this arrangement or circumstances where COPCo shareholders could obtain roll-over under another provision of the ITAA 1997.

29. The volume weighted average price of the COPCo shares as traded on the NYSE (on a deferred or normal settlement basis) over the first five trading days after the demerger takes place is \$USD 54.67.

30. The volume weighted average price of the Phillips 66 shares as traded on the NYSE (on a deferred or normal settlement basis) over the first five trading days after the demerger takes place is \$USD 31.95.

## Ruling

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### **Demerger of Phillips 66**

#### ***CGT event G1***

31. CGT event G1 happens in relation to each COPCo ordinary share held by a COPCo shareholder at the time COPCo made the payment of the capital reduction amount under the demerger (satisfied by the *in specie* distribution of Phillips 66 shares) (section 104-135).

#### ***Capital gain***

32. A COPCo shareholder makes a capital gain from CGT event G1 that happens if the capital reduction amount received for each COPCo share exceeds the cost base of that share. The capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

#### ***Demerger roll-over***

33. COPCo and Phillips 66 are part of a demerger group under subsection 125-65(1).

34. A demerger, as described in section 125-70, happens to this demerger group under the scheme.

35. A COPCo shareholder can choose demerger roll-over relief under subsection 125-55(1) for their COPCo shares.

#### ***CGT consequences of choosing roll-over***

36. A COPCo shareholder who chooses demerger roll-over relief disregards any capital gain made when CGT event G1 happens to their COPCo shares under the demerger (subsection 125-80(1)).

***Other CGT consequences of choosing roll-over***

37. A COPCo shareholder who chooses demerger roll-over must also recalculate the cost base and reduced cost base of their COPCo shares and their new Phillips 66 shares.

38. The first element of the cost base and reduced cost base of each COPCo share and each new Phillips 66 share received under the demerger is worked out (under subsection 125-80(2)) as follows:

- take the sum of the cost bases of the COPCo shares (worked out just before the demerger); and
- apportion that sum over the COPCo shares and new Phillips 66 shares received under the demerger.

39. The apportionment of this sum is done on a reasonable basis having regard to the market values of the COPCo shares just before the demerger and the market values of the COPCo shares and Phillips 66 shares just after the demerger or based upon a reasonable approximation of those market values (subsections 125-80(2) and (3)).

40. The Commissioner accepts that a reasonable apportionment of the total cost base of a COPCo share with a market value of \$USD 71.71 just before the demerger is to:

- attribute 77.39% of the total cost base to the COPCo share just after the demerger; and
- attribute 22.61% of the total cost base to the Phillips 66 shares just after the demerger.

***COPCo shareholders who do not choose demerger roll-over***

41. A COPCo shareholder who does not choose demerger roll-over cannot disregard any capital gain made when CGT event G1 happens to their COPCo share under the demerger.

42. However, the first element of the cost base and reduced cost base of each COPCo share and new Phillips 66 share held after the demerger is calculated in the same manner as if they had chosen demerger roll-over (see paragraphs 38 to 40 of this Ruling) (subsections 125-85(1) and (2)).

***Acquisition date of the Phillips 66 shares for the purposes of a discount capital gain***

43. For the purpose of determining eligibility for a discount capital gain, a Phillips 66 share received by a COPCo shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding COPCo shares (item 2 of the table in subsection 115-30(1)). This will be the case whether or not the COPCo shareholder chooses demerger roll-over relief.

## ***Dividend consequences***

44. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).
45. A COPCo shareholder receives a demerger dividend consisting of a pro rata share of the excess of the money value of the *in specie* distribution of Phillips 66 shares over the amount debited to the share capital account of COPCo (see Taxation Ruling TR 2003/8).
46. The demerger dividend is neither assessable income nor exempt income of the COPCo shareholder (subsections 44(3) and (4) of the ITAA 1936).

## ***Application of sections 45B, 45BA and 45C of the ITAA 1936***

47. 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 COPCo shareholders under the demerger.
48. 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 COPCo shareholders under the demerger.

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**Commissioner of Taxation**

27 June 2012

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## **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.*

### **Conditions for demerger roll-over**

49. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions which must be satisfied for a shareholder to be eligible to choose demerger roll-over relief. The main conditions relevant to the scheme that is the subject of this Ruling are:

- (a) a shareholder owns a share in a company (the original interest) – this condition is satisfied as a participating shareholder owned a COPCo share;
- (b) the company is the head entity of a demerger group – this condition is satisfied as COPCo was the head entity of a demerger group;
- (c) a demerger happens to the demerger group – this condition is satisfied as a demerger happened to the COPCo 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 – this condition is satisfied as CGT event G1 happened to the COPCo shares and a COPCo shareholder received Phillips 66 shares under the demerger.

50. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied in respect of the demerger of Phillips 66. As a consequence, a COPCo shareholder can choose demerger roll-over relief under Division 125 in respect of the demerger.

### **Distribution not a dividend for taxation purposes**

51. Subsection 44(1) 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 a resident of Australia) and from an Australian source (if the shareholder is a non-resident).

52. The term 'dividend' in section 6(1) of the ITAA 1936 includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the share capital account of the company.

53. The term 'share capital account' is defined in section 975-300 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.

54. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted.

55. Should the market value of the *in specie* distribution to COPCo shareholders of Phillips 66 exceed the amount debited to the share capital account, the 'excess amount' would be a 'dividend' pursuant to section 6(1) of the ITAA 1936. Accordingly, the amount that is debited to COPCo's share capital account is not a 'dividend' as defined in section 6(1) of the ITAA 1936, and will not be included in the assessable income of COPCo shareholders under subsection 44(1) of the ITAA 1936.

## **Demerger dividend**

56. COPCo shareholders receive a dividend to the extent that the market value of the Phillips 66 shares distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

57. This dividend is neither assessable income nor exempt income (subsections 44(3) and (4) of the ITAA 1936) if:

- the dividend is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936);
- the head entity did not elect that subsections 44(3) and (4) of the ITAA 1936 do not apply to the demerger dividend (subsection 44(2) of the ITAA 1936); and
- subsection 44(5) of the ITAA 1936 is satisfied.

58. In the present circumstances, each condition in paragraph 57 above is satisfied. Therefore, the dividend received by COPCo shareholders under the demerger is neither assessable income nor exempt income by operation of subsections 44(3) and (4) of the ITAA 1936.

## **Application of sections 45B, 45BA and 45C of the ITAA 1936**

59. 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.

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

61. 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 a COPCo shareholder to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

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

**Appendix 2 – Detailed contents list**

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

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## References

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- Previous draft:*
- ITAA 1936 45B(2)(a)
  - ITAA 1936 45B(2)(b)
- Not previously issued as a draft
- ITAA 1936 45B(3)(a)
  - ITAA 1936 45B(3)(b)
- Related Rulings/Determinations:*
- TR 2006/10; TR 2003/8
- ITAA 1936 45BA
  - ITAA 1936 45C
- Subject references:*
- ITAA 1997 104-135
  - ITAA 1997 104-135(3)
  - capital benefit - ITAA 1997 109-5(2)
  - capital gains - ITAA 1997 115-30
  - cost base adjustments - ITAA 1997 115-30(1)
  - demerger - ITAA 1997 Div 125
  - demerger allocation - ITAA 1997 125-55(1)
  - demerger benefit - ITAA 1997 125-55(2)
  - demerger dividend - ITAA 1997 125-65(1)
  - demerger group - ITAA 1997 125-70
  - demerger subsidiary - ITAA 1997 125-80(1)
  - return of capital on shares - ITAA 1997 125-80(2)
  - ITAA 1997 125-80(3)
  - ITAA 1997 125-85(1)
  - ITAA 1997 125-85(2)
- Legislative references:*
- ITAA 1936 6(1) - ITAA 1997 Div 230
  - ITAA 1936 44 - ITAA 1997 975-300
  - ITAA 1936 44(1) - ITAA 1997 975-300(3)
  - ITAA 1936 44(2)
  - ITAA 1936 44(3) - TAA 1953
  - ITAA 1936 44(4) - Copyright Act 1968
  - ITAA 1936 44(5)
  - ITAA 1936 45B
- 

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