

21 May 2015

Manager of Company Announcements  
ASX Limited  
Level 6, 20 Bridge Street  
SYDNEY NSW 2000

**By E-Lodgement**

**ASX ANNOUNCEMENT – FINAL TAX RULING RECEIVED**

Otto Energy Ltd (ASX: OEL) (“Otto”) is pleased to announce that the Australian Tax Office (“ATO”) has published a final Class Ruling (CR 2015/36) confirming the taxation treatment of the proposed A\$0.064 per share distribution.

The outcome of the Class Ruling is consistent with information previously advised by the Company.

The proposed distribution of A\$0.064 per share comprises:

- A\$0.0564 per share as a return of capital (“Return of Capital”); and
- if shareholders approve the Return of Capital the Board intends to determine an additional A\$0.0076 per share will be returned to shareholders as an unfranked special dividend.

The Class Ruling is attached to this announcement and is available on the ATO website at [www.ato.gov.au](http://www.ato.gov.au).

The taxation implications will depend on the circumstances of the individual Shareholder. Shareholders are encouraged to seek and rely only on their own professional advice in relation to their tax position.

~Ends~

**OTTO AT A GLANCE**

- ASX-listed oil and gas company with a strategy to grow an integrated petroleum business through high impact exploration
- Focused on South East Asia and East Africa
- Formerly Operator of the producing Galoc oil field in the Philippines

**COMPANY OFFICERS**

Rick Crabb	Chairman
Ian Macliver	Director
Rufino Bomasang	Director
John Jetter	Director
Ian Boserio	Director
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## Class Ruling

### Income tax: return of capital: Otto 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

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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 provisions

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-135 of the ITAA 1997
- Division 115 of the ITAA 1997, and
- section 855-10 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936, unless otherwise stated.

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## Class of entities

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

- are registered on the OEL share register on the date (Record Date) for determining entitlements to receive the proposed return of capital
- hold their OEL shares on capital account, 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 OEL 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 an OEL 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 8 to 31 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.

## Date of effect

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7. This Ruling applies from 1 July 2014 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

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

Note: all dollar references in this Ruling are Australian dollars, unless otherwise stated.

### Background

9. OEL is an Australian incorporated and resident company listed on the Australian Securities and Exchange (ASX).

10. OEL holds 100% of the shares on issue in Galoc Production Company WLL (GPC WLL), a company incorporated and resident in Bahrain.

11. GPC WLL has a 33% indirect working interest in Service Contract 14C – an oil and gas operation in the Galoc oil field in the Philippines. The service contract is operated via a branch in the Philippines.

### Sale of GPC WLL

12. On 12 December 2014, OEL entered into a Sale and Purchase Agreement (SPA) to divest 100% of its shares in GPC WLL for a headline value of US\$108,000,000. OEL will record an accounting profit from the sale of GPC WLL.

13. Proceeds of the sale will allow OEL to fund its exploration activities for the next two years, and pay a proposed one-off cash return paid from excess capital to shareholders.

### Proposed return of capital

14. Subject to shareholder approval, pursuant to the *Corporations Act 2001* (Corporations Act), OEL will make a distribution to its shareholders of \$73,970,565 by way of a cash distribution from the proceeds of the GPC WLL sale. The distribution equates to \$0.064 per share (the Distribution).

15. The Distribution will comprise of:

- an unfranked dividend of \$8,754,342.40 being \$0.0076 per share, and
- a return of capital of \$65,216,222.60 being \$0.0564 per share.

16. The Distribution will be paid equally to each holder of an OEL share who is registered on the OEL share register on the Record Date. The Distribution will not result in the cancellation of any shares.

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17. OEL will debit the return of capital entirely against its share capital account.
18. The unfranked dividend of \$0.0076 per share will be paid out of OEL's current year profit.
19. The remaining funds will be used as a working capital injection to fund activities for two years.
20. The Record Date and date for the return of capital (Payment Date) are yet to be determined.

## **Capital structure**

21. OEL has a single class share capital structure consisting of ordinary shares.
22. As at 15 April 2015, OEL's contributed equity was \$131,577,000.
23. As at 25 September 2014, OEL had 1,155,790,071 fully paid ordinary shares on issue with a share price of \$0.098, providing a market capitalisation of \$113.27 million.
24. OEL's share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted (within the meaning of Division 197 of the ITAA 1997).
25. An OEL share is not an 'indirect Australian real property interest' (as defined in section 855-25 of the ITAA 1997).
26. OEL's franking account balance was nil as at 15 April 2015.

## **OEL's foreign resident shareholders**

27. As at 15 April 2015, approximately 57% of OEL shares were held by foreign shareholders.

## **Other matters**

28. OEL has never declared a dividend to shareholders.
29. Other than the unfranked dividend forming part of the Distribution, OEL has not forecast the declaration of a dividend to its shareholders in the foreseeable future, based on its proposed business operations.
30. As at 30 June 2014, OEL's accumulated group loss balance was US\$53.5 million.

## **Ruling**

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### **Return of capital is not a dividend**

31. The return of capital that will be paid to OEL shareholders will not be a dividend, as defined in subsection 6(1).

### **The application of 45A, 45B and 45C**

32. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies in relation to the return of capital received by OEL shareholders.

### **Capital gains tax (CGT) consequences**

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

33. CGT event G1 (section 104-135 of the ITAA 1997) will happen when OEL pays the return of capital of \$0.0564 share to an OEL shareholder in respect of an OEL ordinary share they own at the Record Date and continue to own at the Payment Date.

#### ***CGT event C2***

34. CGT event C2 (section 104-25 of the ITAA 1997) will happen when OEL pays the Distribution of \$0.064 per share to an OEL Shareholder in respect of an OEL ordinary share they own at the Record Date, but cease to own before the Payment Date.

### **Foreign resident shareholders**

35. An OEL Shareholder who is a foreign resident just before CGT event G1 happens disregards any capital gain made when CGT event G1 happens if their OEL shares did not constitute 'taxable Australian property' (sections 855-10 and 855-15 of the ITAA 1997).

36. A OEL Shareholder who is a foreign resident just before CGT event C2 happens disregards any capital gain or loss made when CGT event C2 happens if their right to the return of capital is not in respect of 'taxable Australian property' (sections 855-10 and 855-15 of the ITAA 1997).

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**Commissioner of Taxation**

20 May 2015

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## Appendix 1 – Explanation

**ⓘ** *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.*

### **Return of capital is not a dividend**

37. The term 'dividend' is defined in subsection 6(1) and includes a distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

38. '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 after 1 July 1998 where the first amount credited to the account was an amount of share capital.

39. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account, except for certain purposes, if it is tainted.

40. The return of capital will be recorded as being wholly debited to OEL's share capital account. As OEL's share capital account is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly, the return of capital of \$0.0564 per share will not be a dividend as defined in subsection 6(1).

### **Anti-avoidance provisions**

41. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of capital amount received by the OEL shareholders as an unfranked dividend paid by the company out of profits.

### **Section 45A – streaming of dividend and capital benefits**

42. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who would derive a greater benefit from the capital benefits than the other shareholders (the disadvantaged shareholders) and it is reasonable to assume that the disadvantaged shareholders have received, or will receive, dividends.

43. Although OEL will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), the capital benefit is to be provided to all OEL shareholders in direct proportion to their individual shareholding.

44. Accordingly, section 45A will not apply to the return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the proposed return of capital to shareholders of OEL.

#### **Section 45B – scheme to provide capital benefits**

45. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is 'provided with a capital benefit' by a company (paragraph 45B(2)(a)), and
- under the scheme a taxpayer (the relevant taxpayer) who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)), and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

46. The arrangement involving the return of capital to OEL shareholders will constitute a scheme for the purposes of section 45B.

47. The return of capital will be recorded as debit to OEL's share capital account and OEL shareholders will receive a distribution of share capital to the value of \$0.0564 per share. Therefore, OEL shareholders will be provided with a capital benefit (paragraph 45B(5)(b)).

48. Paragraph 45B(2)(c) sets out an objective purpose test for the Commissioner to consider having regard to the 'relevant circumstances' of the scheme as set out in subsection 45B(8).

49. OEL will record an accounting profit from the sale of GPC WLL. OEL will make a Distribution to OEL shareholders, which will comprise of two components, an unfranked dividend and a return of capital. The amount of the unfranked dividend can be reasonably regarded as attributable to the profit from the sale of GPC WLL.

50. Further, the amount of the return of capital can be reasonably regarded as attributable to the share capital invested by OEL in the assets disposed of by the sale of GPC WLL.

51. Having regard to the relevant circumstances, it cannot be concluded that OEL will enter into or carry out the scheme for a more than incidental purpose of enabling the OEL shareholders to obtain a tax benefit.

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52. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part, of the payment for the return of share capital.

## **CGT consequences**

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

53. CGT event G1 (section 104-135 of the ITAA 1997) happens when a company makes a payment to a shareholder in respect of a share they own and some or all of the payment (the non-assessable part) is not a dividend or an amount that is taken to be a dividend under section 47.

54. Accordingly, CGT event G1 will happen when OEL pays the return of capital to an OEL shareholder in respect of a share that they own at the Record Date and continue to own at the Payment Date.

55. An Australian resident OEL shareholder will make a capital gain if the capital return amount is more than the cost base of the shareholder's OEL share. The amount of the capital gain is equal to that excess (subsection 104-135(3) of the ITAA 1997).

56. If an Australian resident shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the OEL share is reduced to nil. An Australian resident shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3) of the ITAA 1997).

57. If the return of capital is equal to or less than the cost base of the OEL share at the Payment Date, the cost base and reduced cost base of the ordinary share will be reduced by the amount of the non-assessable part of the payment (subsection 104-135(4) of the ITAA 1997).

58. A capital gain made when CGT event G1 happens will be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that the OEL share was acquired at least 12 months before the payment of the return of share capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Division are satisfied.

### ***CGT event C2***

59. The right to receive the Distribution is one of the rights inherent in the OEL share at the Record Date. If, after the Record Date but before the Payment Date, an OEL shareholder ceases to own an OEL share in respect of which the Distribution was payable, the right to receive the Distribution in respect of that share is retained by the shareholder and is considered to be a separate CGT asset.

60. CGT event C2 will happen when the Distribution is paid (section 104-25 of the ITAA 1997). The right to receive the payment ends by the right being discharged or satisfied when the payment is made.

61. An Australian resident OEL shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. An Australian resident OEL shareholder will make a capital loss if the capital proceeds from the ending of the right are less than its reduced cost base. The capital loss is equal to the amount of the difference (subsection 104-25(3) of the ITAA 1997).

62. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the Distribution paid by OEL (subsection 116-20(1) of the ITAA 1997).

63. The cost base of the OEL shareholder's right to receive the return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by an OEL shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happens to the share, for example, when the OEL shareholder disposed of it after the Record Date.

64. Therefore, if the full cost base or reduced cost base of the OEL share was applied in working out a capital gain or capital loss made when a CGT event happens to that share, the right to receive the Distribution will generally have a nil cost base. As a result, the OEL shareholder will generally make a capital gain equal to the amount of the Distribution.

65. As the right to receive the payment of the Distribution was inherent in the OEL share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997).

66. Accordingly, if the OEL share was acquired at least 12 months before the payment of the Distribution, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain may be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997, provided other conditions of that Division are satisfied.

67. Any capital gain made as a result of CGT event C2 happening to a former OEL shareholder's right to receive the Distribution will be reduced by that part of the payment (\$0.0076 per share) included in the former OEL shareholder's assessable income as an unfranked dividend (section 118-20 of the ITAA 1997).

### **Foreign resident shareholders**

68. Under subsection 855-10(1) of the ITAA 1997, 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'.

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69. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property
Item 2	an indirect Australian real property interest not covered by 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 item 1, 2 or 5
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident)

70. Neither the OEL share nor an OEL shareholder's right to the Distribution is an 'indirect Australian real property interest' as defined in section 855-25 of the ITAA 1997, and therefore not taxable Australian property.

71. A foreign resident who is an OEL shareholder who receives the Distribution will disregard any capital gain made when CGT event G1 happens and disregard any capital gain or capital loss if CGT event C2 happens.

**Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- capital benefit
- capital gains tax
- capital reductions
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 - shares
- distributions
- dividend income
- ordinary shares
- profits
- return of capital on shares
- shareholder payments
- unfranked dividends

*Legislative references:*

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Div 115
- ITAA 1997 115-25
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 118-20
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-25
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- TAA 1953
- Corporations Act 2001

ATO references

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Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 - shares

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