

Tax implications for ARC Shareholders

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10 Tax implications for ARC Shareholders

10.1 General

This section contains a summary of the Australian tax implications of the Scheme for ARC Shareholders who are residents of Australia for tax purposes and who hold their ARC Shares as capital assets. The summary is not tax advice, and is intended as a general guide only. It does not purport to contain a complete analysis of all the potential tax implications of the Scheme.

The summary below does not necessarily apply to ARC Shareholders who hold their ARC Shares as assets used in carrying on a business or who carry on the business of share trading, banking or investment. The summary does not necessarily apply to ARC Shareholders whose ARC Shares were acquired under the ARC Employee Share Option Plan or the ARC Performance Rights Plan. The summary does not take account of the individual circumstances of particular ARC Shareholders. The summary does not apply to ARC Shareholders who are not residents of Australia for tax purposes. ARC Shareholders should seek specialist tax advice applicable to their own individual circumstances from their financial or tax advisers.

The summary is based on the law in effect as at the date of this Scheme Booklet. The law on which the summary is based may be subject to future amendments with retrospective effect.

10.2 Class Rulings

ARC has applied to the Commissioner for the ARC Class Ruling confirming the tax implications set out in the summary below. Any ARC Class Ruling which the Commissioner issues will only apply to ARC Shareholders who are Australian residents for tax purposes and who hold their shares as capital assets. ARC cannot provide any assurances that the requested ARC Class Ruling will in fact be issued, or that it will confirm the position set out in the summary below. The tax implications of the Scheme may therefore differ from the tax implications set out below.

Once issued, ARC will make the ARC Class Ruling available on its website (www.arcenergy.com.au).

10.3 Demerger

10.3.1 If demerger rollover relief is available

ARC has sought the Commissioner's confirmation that ARC Shareholders will be able to choose demerger rollover relief in relation to the Demerger. If the Commissioner confirms that demerger rollover relief is available, the tax implications for ARC Shareholders will be as follows.

If ARC Shareholders choose to obtain demerger rollover relief:

- (a) any capital gain or capital loss that they make as result of the Demerger will be disregarded;
- (b) the cost base and reduced cost base of their ARC Shares and Buru Energy Shares will be calculated on the following basis:
 - the pre-Demerger cost base of each ARC Share will be reasonably apportioned between each ARC Share and each Buru Energy Share held after the Demerger;
 - the apportionment will reflect the proportion of the anticipated market value of the ARC Share and Buru Energy Share just after the Demerger;
- (c) for CGT purposes, ARC Shareholders will be taken to have acquired their Buru Energy Shares on the same date they acquired their ARC Shares.

Example 1¹

Lisa acquires 10,000 ARC Shares for \$10,900 on 1 April 2007 (i.e. **Pre-Demerger cost base** is \$1.09 for each ARC Share). For the purposes of this example it is assumed that:

- **ARC Share price:** the last closing price of ARC Shares on ASX before the Demerger is \$1.63;
- **ARC post-Demerger MV:** the value of each ARC Share just after the Demerger is \$1.414²;
- **Buru post-Demerger MV:** the market value of each Buru Energy Share just after the Demerger is \$0.525³. This equates to \$0.223125 per 0.425 Buru Energy Shares, which is the number of Buru Energy Shares which Lisa will receive under the Scheme for each of her ARC Shares;
- **percentage of the Total post-Demerger MV of ARC and Buru represented by the ARC post-Demerger MV:** 86.3709%; and
- **percentage of the Total post-Demerger MV of ARC and Buru represented by the Buru post-Demerger MV:** 13.6291%.

At the Implementation Date, \$2,231.25 in cash (i.e. \$0.223125 in respect of each ARC Share) is applied on Lisa's behalf to the purchase of Buru Energy Shares from ARC. Lisa receives 4,250 Buru Energy Shares, i.e. 0.425 Buru Energy Shares for each of her ARC Shares.

Lisa chooses to obtain demerger relief.

Lisa will be taken to have acquired her Buru Energy Shares at the time she acquired her ARC Shares (i.e. on 1 April 2007).

The first element of the cost base of Lisa's ARC Shares and Buru Energy Shares is determined in the following manner.

First element of cost base
of ARC Shares = Total Pre-Demerger cost base x percentage of the Total post-Demerger MV of ARC and Buru
represented by the ARC post-Demerger MV
= \$10,900 x 86.3709%
= \$9,414.43

This equates to \$0.941443 per ARC Share.

First element of cost base
of Buru Energy Shares = Total Pre-Demerger cost base x percentage of the Total post-Demerger MV of ARC and Buru
represented by the Buru post-Demerger MV
= \$10,900 x 13.6291%
= \$1,485.57

This equates to \$0.349546 per Buru Energy Share.

(The reference to "first element" reflects the fact that ARC Shareholders may have other elements affecting their cost base).

For the purpose of assisting Scheme Shareholders in preparing their future tax returns, Buru Energy will write to Scheme Shareholders advising them of the actual values for the assumed amounts set out above.

1 The prices of AWE Shares and Buru Energy Shares used in these examples are for illustrative purposes only. AWE Shares and Buru Energy Shares are likely to trade at prices that are different to those used in these examples. ARC Shareholders should also note that the Buru Energy Shares have no trading history.

2 This amount, being the value of the cash and AWE Share components of the Scheme Consideration at the Implementation Date (assuming an AWE Share price of \$4.08 on the Implementation Date), has been used for the purposes of this example. It should be noted that the Commissioner may require ARC Shareholders' tax returns to be prepared on a different basis. Further details will be provided to ARC Shareholders in due course.

3 This amount, being the mid-point of the Independent Expert's valuation of Buru Energy Shares, has been used for the purposes of this example. It should be noted that the Commissioner may require ARC Shareholders' tax returns to be prepared on a different basis. Further details will be provided to ARC Shareholders in due course.

10 Tax implications for ARC Shareholders

10.3.2 Mechanics of choice

No formal election is required to be lodged in order to choose to obtain demerger rollover relief. ARC Shareholders who choose to obtain demerger rollover relief should prepare their income tax returns in a manner consistent with their choice.

10.3.3 Capital Reduction

If the ARC Class Ruling is issued in accordance with the application made by ARC, the Capital Reduction Amount should not be treated (in whole or in part) as a dividend for Australian tax purposes. ARC Shareholders should not be required to include the Capital Reduction Amount in their assessable income.

10.3.4 Demerger Dividend

If the Commissioner makes the ARC Class Ruling in accordance with ARC's application, ARC Shareholders should not be required to include the Demerger Dividend in their assessable income. The Demerger Dividend will not be franked.

It should be noted that, for income tax purposes, the Commissioner may require the Demerger Dividend amount to be calculated on a different basis to that set out in the definition of Demerger Dividend in Section 18. Further details will be provided to ARC Shareholders in due course.

10.3.5 CGT consequences of future disposal of Buru Energy Shares

Buru Energy Shareholders who dispose of their Buru Energy Shares acquired under the Scheme will be required to include a capital gain or a capital loss in calculating their taxable income. Buru Energy Shareholders will make a capital gain if the capital proceeds they receive on disposal exceed the cost base of their Buru Energy Shares (as determined above). Buru Energy Shareholders who are individuals, trusts or complying superannuation entities may be entitled to reduce their capital gain (after taking into account capital losses) by the CGT discount if they have held their Buru Energy Shares for at least 12 months prior to the time of the relevant CGT event (excluding the acquisition and disposal dates). If demerger rollover relief applies and is chosen, the Buru Energy Shares will be taken to have been acquired on the date the original ARC Shares were acquired.

Buru Energy Shareholders will make a capital loss if the capital proceeds they receive from the disposal are less than the reduced cost base of the Buru Energy Shares (as determined above). A capital loss can only be used to offset capital gains and cannot otherwise be deducted from assessable income.

10.3.6 Future dividends

Buru Energy Shareholders will be required to include in their assessable income any future dividends they receive from Buru Energy. If the dividends are franked, Buru Energy Shareholders will also be required to include the franking credit in their assessable income and will receive a tax offset equal to the franking credit.

10.4 Merger

Scrip for scrip rollover

ARC has applied for the ARC Class Ruling confirming that scrip for scrip rollover is available to ARC Shareholders. If the Commissioner confirms that scrip for scrip rollover is available, the tax implications for ARC Shareholders will be as follows.

10.4.1 If no scrip for scrip rollover relief is chosen

If ARC Shareholders do not choose to obtain scrip for scrip rollover relief, they will be required to include in their assessable income a capital gain arising upon the transfer of their ARC Shares to AWE Australia. The capital gain will equal the difference between the cost base of the ARC Shares and the capital proceeds received from AWE. The cost base of the ARC Shares will need to take into account the adjustments made as a result of the Demerger, discussed above. The capital proceeds will equal the sum of the value of the New AWE Shares and the cash component received from AWE in consideration of the transfer of ARC Shares.

10.4.2 If scrip for scrip rollover relief is chosen

ARC Shareholders who choose to obtain scrip for scrip rollover relief will not be required to include in their assessable income that portion of their capital gain that is attributable to the New AWE Shares received from AWE. However, they will be required to include in their assessable income that portion of their capital gain that is attributable to the cash consideration they receive from AWE.

In calculating the extent to which their capital gain is attributable to cash consideration received from AWE, ARC Shareholders will be entitled to deduct a reasonable portion of the cost base of their ARC Shares (just prior to disposal) from the value of the cash consideration.

Example 2

Lisa's cost base in her ARC Shares was adjusted to \$9,414.43 as a result of the Demerger (i.e. \$0.941443 for each ARC Share, as set out in Example 1).

Lisa does not elect to receive the Maximum Cash Alternative that is available under the Scheme. On the Implementation Date, Lisa receives \$1,900 (i.e. \$0.19 for each ARC Share) and 3,000 AWE Shares (i.e. 0.3 AWE Shares for each ARC Share). For the purposes of this example, the market value of AWE Shares at the Implementation Date is assumed to be \$4.08.

Lisa chooses to obtain scrip for scrip rollover relief.

$$\begin{aligned}\text{Total proceeds} &= \text{Cash component} + \text{Scrip component} \\ &= \$1,900 + (3,000 \times \$4.08) \\ &= \$14,140\end{aligned}$$

$$\begin{aligned}\text{Cost base of cash component} &= \frac{\text{Cost base of ARC Shares} \times \text{Cash component}}{\text{Total proceeds}} \\ &= \frac{\$9,414.43 \times \$1,900}{\$14,140} \\ &= \$1,265.02\end{aligned}$$

$$\begin{aligned}\text{Capital gain} &= \text{Cash component} - \\ &\quad \text{Cost base of cash component} \\ &= \$1,900 - \$1,265.02 \\ &= \$634.98\end{aligned}$$

As Lisa held her ARC Shares for more than 12 months, the CGT discount should apply to reduce her capital gain to half of \$634.98, i.e. \$317.49.

10.4.3 Future dividends

ARC Shareholders who become holders of AWE Shares will be required to include in their assessable income any future dividends they may receive from AWE. If the dividends are franked, shareholders will also be required to include the franking credit in their assessable income and will receive a tax offset equal to the franking credit.

10.4.4 CGT consequences of future disposal

ARC Shareholders may make a capital gain or a capital loss on any future disposal of New AWE Shares acquired under the Scheme. Whether a capital gain or a capital loss is made will depend on whether the capital proceeds from the disposal of the New AWE Shares are more than the cost base or less than the reduced cost base of the New AWE Shares.

If ARC Shareholders choose to obtain scrip for scrip rollover relief, the first element of their cost base in their New AWE Shares will equal the cost base of the ARC Shares transferred to AWE Australia (reduced by the amount of the cost base taken into account in determining the taxable capital gain, discussed above).

Example 3

The first element of the cost base of Lisa's New AWE Shares is determined in the following manner (as set out in Examples 1 & 2).

Cost base of ARC Shares	=	\$9,414.43
Cost base of cash component	=	\$1,265.02
First element of cost base of each New AWE Share	=	$\frac{(\text{Cost base of ARC Shares} - \text{Cost base of cash component})}{\text{Number of New AWE Shares}}$
	=	$\frac{\$9,414.43 - \$1,265.02}{3,000}$
	=	\$2.71647

If ARC Shareholders do not elect to obtain scrip for scrip rollover relief, the first element of the cost base of their New AWE Shares will equal that proportion of the market value of the ARC Shares at the time of their disposal to AWE Australia (i.e. as at the Implementation Date) that is attributable to the New AWE Shares (as distinct from that proportion of the market value of the ARC Shares that is attributable to the cash consideration).

Example 4

If Lisa does not elect to receive the Maximum Cash Alternative and does not choose to obtain scrip for scrip rollover relief, the first element of the cost base of her New AWE Shares will be determined in the following manner (as set out in Examples 1 & 2).

Total proceeds	=	Cash component + Scrip component
	=	\$1,900 + (3,000 x \$4.08)
	=	\$14,140
First element of cost base of New AWE Shares	=	$\frac{\text{Post-Demerger MV of ARC Shares} \times \text{Value of New AWE Shares}}{\text{Total proceeds}}$
	=	$\$14,140 \times \$12,240 / \$14,140$
	=	\$12,240
First element of cost base of each New AWE Share	=	$\frac{\$12,240}{3,000}$
	=	\$4.08

ARC Shareholders who become holders of AWE Shares and who are individuals, trusts or complying superannuation entities may be entitled to reduce their capital gain (after taking into account capital losses) by the CGT discount if they have held their AWE Shares for at least 12 months prior to the time of the relevant CGT event (excluding the acquisition and disposal dates).

For CGT purposes, ARC Shareholders who have chosen to obtain scrip for scrip rollover relief will be taken to have acquired their New AWE Shares at the time when they acquired the ARC Shares for which they were exchanged.

For CGT purposes, ARC Shareholders who have not chosen to obtain scrip for scrip rollover relief will be taken to have acquired their New AWE Shares at the time their New AWE Shares were issued under the Scheme (i.e. on the Implementation Date).

Any capital loss made in respect of the disposal of AWE Shares may be available to be offset against capital gains made in the same income year or carried forward to be offset against capital gains made in future income years. A capital loss cannot otherwise be deducted from assessable income.

10.4.5 Mechanics of choice

No formal election is required to be lodged in order to choose to obtain scrip for scrip rollover relief. ARC Shareholders who choose to obtain scrip for scrip rollover relief should prepare their income tax returns in a manner consistent with their choice.

10 Tax implications for ARC Shareholders

10.5 Other Australian taxes

No GST or stamp duty will be payable in connection with the Scheme by ARC Shareholders who are residents of Australia.

10.6 If the ARC Class Ruling does not issue

This section sets out the consequences to ARC shareholders who are residents of Australia and who hold their ARC Shares on capital account if the Commissioner does not issue the ARC Class Ruling in accordance with the application made by ARC.

10.6.1 If capital gains tax demerger relief is not available

If the Commissioner expresses the view that demerger rollover relief is not available, then, unless an ARC Shareholder successfully challenges that view in a court:

- (a) any capital gain or capital loss that ARC Shareholders make as a result of the Demerger will not be disregarded. ARC Shareholders will make a capital gain if the Capital Reduction Amount (less any amount determined by the Commissioner to be an unfranked dividend) exceeds the cost base of their ARC Shares. ARC shareholders who are individuals, trusts or complying superannuation entities may be entitled to reduce their capital gain (after taking into account capital losses) by the CGT discount if they have held their ARC Shares for at least 12 months prior to the Implementation Date (excluding the acquisition date and the Implementation Date);
- (b) unless the Commissioner makes a determination that all or part of the Capital Reduction Amount should be treated as an unfranked dividend, the cost base and reduced cost base of the ARC Shares will be reduced by the Capital Reduction Amount;
- (c) the cost base and reduced cost base of the Buru Energy Shares will be equal to the Capital Reduction Amount and the Demerger Dividend amount; and
- (d) for CGT purposes, ARC Shareholders will be taken to have acquired their Buru Energy Shares on the Implementation Date.

10.6.2 Capital Reduction Amount may be treated as an unfranked dividend

If the Commissioner so determines, the Capital Reduction Amount will be treated (in whole or in part) as an unfranked dividend for Australian tax purposes. In that case, ARC Shareholders will be required to include the part of the Capital Reduction Amount determined to be an unfranked dividend in their assessable income, and non-resident ARC Shareholders will be required to pay withholding tax on that part of the Capital Reduction Amount.

10.6.3 Demerger Dividend will be an unfranked dividend

If the Commissioner does not confirm that demerger relief is available, ARC Shareholders will be required to include the Demerger Dividend in their assessable income. The Demerger Dividend will not be franked.

It should be noted that, for income tax purposes, the Commissioner may require the Demerger Dividend amount to be calculated on a different basis to that set out in the definition of Demerger Dividend in Section 18. Further details will be provided to ARC Shareholders in due course.

10.6.4 Scrip for scrip rollover

If the Commissioner expresses the view that scrip for scrip rollover relief is not available then, unless an ARC Shareholder successfully challenges that view in a court, ARC Shareholders will be required to include in their assessable income a capital gain arising on the transfer of their ARC Shares to AWE Australia.

10.6.5 CGT consequences of future disposal of Buru Energy Shares

Buru Energy Shareholders who dispose of their Buru Energy Shares acquired under the Scheme will be required to include a capital gain or a capital loss in calculating their taxable income. Buru Energy Shareholders will make a capital gain if the capital proceeds they receive on disposal exceed the cost base of their Buru Energy Shares. The cost base of the Buru Energy Shares will be equal to the Capital Reduction Amount and the Demerger Dividend amount.

Buru Energy Shareholders who are individuals, trusts or complying superannuation entities may be entitled to reduce their capital gain (after taking into account capital losses) by the CGT discount if they have held their Buru Energy Shares for at least 12 months prior to the time of the relevant CGT event (excluding the acquisition and disposal dates). For CGT purposes, ARC Shareholders will be taken to have acquired their Buru Energy Shares on the Implementation Date.

Buru Energy Shareholders will make a capital loss if the capital proceeds they receive from the disposal are less than the reduced cost base of the Buru Energy Shares (as determined above). A capital loss can only be used to offset capital gains and cannot otherwise be deducted from assessable income.