Demergers—where is the value?

Recent professional development seminars covered demergers and licensing of responsible officers.

Demerging non-core businesses became more attractive to Australian companies with the Capital Gains Tax (CGT) rollover relief introduced in 2002. But is tax relief in itself sufficient reason to demerge or should the decision be more strategic and based on value creation? And does a demerger create value or jeopardise it?

Larry Magid, a partner with leading legal firm Allen Arthur Robinson and a specialist in corporate and international tax, emphasised at a Securities Institute professional development seminar that demergers do not bring tax benefits. Tax benefits are not what demergers are about, he said. Nevertheless, the tax relief for demergers has enabled a wider range of demergers to take place.

Until the middle of last year (2002), there were significant tax impediments to demerging in Australia—in the sense of spinning off or splitting off assets, or any transaction in which a company seeks to divest a subsidiary to its shareholders.

It was argued to the government that if a parent company proposes to make a pro-rata distribution of shares in a subsidiary to its shareholders, there is no change in the ultimate beneficial economic ownership of the entities; therefore there should not be tax impediments to the restructuring taking place.

It was further argued that tax impediments to those restructurings were impediments to the most efficient formation of business and allocation of capital, and should be removed. Their removal would actually benefit, rather than prejudice, revenues.

Magid made the point that, given the existence of tax impediments, transactions frustrated by them simply did not take place; the government did not receive revenue that would otherwise flow from the tax consequences of a demerger because the deals just did not happen. With tax impediments removed, the government sacrifices revenue from demergers but shareholders have two pieces of paper instead of one and are marginally more likely to trade one or the other, giving rise to potential tax revenues.

Geoff Joyce, executive director, corporate finance, Macquarie Bank, noted that the rationale or fashion for business structures changes with time, for example from the successful conglomerates which dominated the 1950s to the 1970s, to the break-up of these in the 1980s to determine where the value resided, a trend that continued into the 1990s and is evident today in the greater focus on divesting of non-core assets and increased emphasis on strategy.

Joyce pointed out that although there are successful Australian conglomerates, for example, Wesfarmers and the ‘new’ CSR, the key word generally is focus rather than diversity. While agreeing with Magid’s comment that the purpose of a demerger is not to gain a tax benefit, Joyce said that there has been much more press attention on, and discussion of, demergers since the 2002 legislation.

Among the benefits to be gained from a demerger, Joyce cited the potential to improve business performance through incentives which energise management and market re-rating as analysts gain a better understanding of the business, improved management focus, financial flexibility, greater investor choice and enhanced corporate governance because of increased transparency.

On the other hand, among the risks associated with a demerger are the potential to expose an immature business, the impact on debt/financing costs, possibly reduced franking capacity, a reduced investor base and potentially contentious issues such as which side of the business is saddled with debt post-demmerger and which employees go where.

In conclusion, Joyce said that demergers tend to be seen as the latest technique but in fact they have existed for some time. Undoubtedly the new legislation has enabled certain transactions to take place which previously would have been blocked by tax hurdles. As to the debate between focus and diversity, it is a matter of which better suits what situation.

Licensing—who is responsible?

Jennifer Lewis, Senior Manager, FSR Licensing, Australian Securities and Investments Commission (ASIC), took her audience through the steps and rationale for Policy Statement 164 and the licensing of responsible officers in financial services companies.

Lewis stressed that the concept of competence, not liability, is at the core of 164. In reviewing licence applications, ASIC looks at the nature of a business and, in terms of assessing responsible officers, at whether those proposed are key decision-makers in managing the business, those who are directly responsible for day-to-day decisions.

In the case of a company offering only one financial service, it need only have a responsible officer competent for that one service; if a company offers a range of financial services then it needs to appoint at least one person in the organisation who can address each of the services offered. Lewis said that that might sound obvious, but people often forget to cover the range required.

Sam Brown from the professional services firm SSAMM Management Consultants said that the focus on responsible officers reflects the importance the industry and ASIC place on the need for appropriate selection of responsible officers.

Brown said that there is no set formula for approaching the selection of responsible officers and the closest there is to a definition is that a responsible officer is someone who performs duties that are in connection with the holding of a licence.

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