Australian Government
Australian Taxation Office

Australian Taxation Office Legislative Instrument
Instrument ID: 2011/ITX/0011

A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where A Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2011

Explanatory Statement

General Outline of Instrument

1. This instrument is made under subsection 29-25(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).[1]

2. The instrument is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

3. The legislative instrument is necessary to prevent the provisions of Division 29 and Chapter 4 applying in a way that is inappropriate in particular circumstances under a deferred transfer farm-out arrangement[2] to which draft Miscellaneous Taxation Ruling MT 2011/D2 applies. As explained below at paragraphs 5 to 7, under a deferred transfer farm-out arrangement certain supplies and acquisitions are subject to preconditions being satisfied.

4. The circumstances of Division 29 and Chapter 4 applying inappropriately to a supply or acquisition made under a contract that is subject to preconditions is covered by paragraph 29-25(2)(f).

Relevance of draft Miscellaneous Tax Ruling MT 2011/D2

5. Draft Miscellaneous Tax Ruling MT 2011/D2 Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements explains how the GST and income tax law applies to a deferred transfer farm-out arrangement.

[1] All legislative references in this explanatory statement are to provisions in the GST Act unless otherwise specified.
[2] A deferred transfer farm-out arrangement means an arrangement where the transfer of the interest in the mining tenement from the farmor to the farmee occurs only if the farmee meets all of its exploration expenditure and payment (if any) commitments for the transfer of that interest, and the arrangement is one to which MT 2011/D2 applies.

6. As explained in the draft Ruling,[3] the supply of the interest in the mining tenement by the farmor[4] is in return for the supply by the farmee[5] of exploration benefits that flow to the farmor from the farmee's exploration commitments, and any cash payments by the farmee that are in connection with that supply. However, the interest in the mining tenement is only transferred by the farmor if the farmee completes (at the farmee's discretion) the exploration and any payment[6] commitments to earn that interest (the earn-in requirements) within the required time (the earn-in period) and exercises the right (option) to acquire that interest. These are effectively conditions that must be met if there is to be a supply of the interest in the mining tenement by the farmor, and an acquisition of that interest by the farmee.

7. It is the nature of deferred transfer farm-out arrangements that a farmee may (and often does) cease exploration before the earn-in requirements have been met, in which case the farmee cannot exercise the right to acquire the percentage interest in the mining tenement.

Commencement

8. The instrument commences on 24 August 2011.

9. This date is the date from which draft Miscellaneous Tax Ruling MT 2011/D2 applies.

Subsection 12(2) of the Legislative Instruments Act 2003

10. Under subsection 12(2) of the *Legislative Instruments Act 2003*, this instrument does not adversely affect the rights or liabilities of any person other than the Commonwealth.

11. The legislative instrument provides certainty that the farmor does not have to account for GST payable (on a taxable supply of the interest in the mining tenement) when the farmee commences the exploration work which, as explained in MT 2011/D2, results in the provision of exploration benefits to the farmor. Instead the rules in the legislative instrument make it clear that the GST payable is attributable to a later tax period.

12. The legislative instrument ensures that the earliest tax period to which input tax credits are attributable for a farmee aligns with the earliest tax period in which an input tax credit could be claimed by the farmee. An input tax credit could not be claimed by the farmee before it holds a tax invoice issued by the farmor (subsection 29-10(3)) and a farmor could not issue a tax invoice for a supply until, at the earliest, an obligation crystallises for the farmor to transfer the interest in the mining tenement. This provides certainty that the four year time limit for the farmee to claim input tax credits does not run from the tax period determined under subsection 29-10(1) or (2) given that the farmee could not claim an input tax credit until a later tax period.

13. The outcomes under the legislative instrument for the farmor and the farmee are illustrated at paragraphs 23 to 26 of this explanatory statement.

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[3] Paragraph 30 of MT 2011/D2.

[4] Farmor means the owner of an interest in a mining tenement who enters into a deferred transfer farm-out arrangement with the characteristics as set out in paragraph 14 of MT 2011/D2.

[5] Farmee means the other party who, along with the farmor, enters into a deferred transfer farm-out arrangement with the characteristics as set out in paragraph 14 of MT 2011/D2 and who undertakes exploration expenditure and payment (if any) commitments under that arrangement to earn an interest in the mining tenement.

[6] This does not include any payment(s) made for the supply of the right to acquire an interest in the mining tenement or any payment(s) made for the grant of exclusive use and access rights.

Application

14. The instrument applies if a farmor and a farmee have entered into a deferred transfer farm-out arrangement on or after the commencement date of this instrument and the arrangement is covered by draft Ruling MT 2011/D2.

15. As the attribution rules in the instrument are premised on the farmor not being required to transfer the percentage interest in the mining tenement to the farmee unless and until the farmee satisfies the exploration expenditure commitments and exercises the right to acquire the interest, the instrument applies on that basis.

16. The attribution rules in this legislative instrument only override the basic attribution rules and the special rules in Chapter 4 of the GST Act to the extent of any inconsistency and only to the extent provided for in the legislative instrument.

What the instrument is about

17. The instrument sets out the attribution rules that override the basic attribution rules (under section 29-5) to attribute GST payable if a farmor receives exploration benefits as consideration (or part of the consideration) for the supply of an interest in a mining tenement and before the farmor knows if the farmee will exercise the right to acquire that interest.

18. It also sets out the attribution rules that apply in place of the basic attribution rules (under section 29-10) to attribute input tax credits if the farmee exercises the right to acquire the interest in the mining tenement and it is a creditable acquisition for the farmee.

What is the effect of this instrument

Farmor

19. If the farmor accounts for GST on a basis other than cash (a 'non-cash basis'), the legislative instrument ensures that the GST payable on the taxable supply of the interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire the interest in the mining tenement. Effectively, a non-cash basis farmor and farmee can exchange tax invoices upon the farmee exercising the right to acquire the interest in the mining tenement and account for GST payable and claim any input tax credits in that tax period. To the extent that it is a barter transaction and the acquisitions are fully creditable, it is a wash[7] transaction for the farmor and for the farmee.

20. The legislative instrument ensures that if the farmor accounts for GST on a cash basis, the GST payable on the taxable supply of the interest in the mining tenement is attributable to the tax period in which the interest is transferred. This aligns with when a cash basis farmor can claim an input tax credit for the acquisition of the exploration benefits (assuming the farmee has issued a tax invoice[8] to the farmor for the exploration benefits by this time).

[7] That is, the GST payable equals the input tax credit able to be claimed by each party.
[8] The farmor must hold a tax invoice to claim an input tax credit: subsection 29-10(3).

Farmee

21. The legislative instrument ensures that if the farmee accounts for GST on either a cash or a non-cash basis, the input tax credit for a creditable acquisition of the interest in the mining tenement is attributed to a tax period no earlier than first tax period in which the farmor could issue the farmee with a tax invoice and the farmee could claim an input tax credit.[9] The legislative instrument ensures that the four year time limit for claiming input tax credits does not run from a tax period when the farmee could not claim input tax credits as at that time there is no certainty as to the farmee making an acquisition, and thus a creditable acquisition, and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply. Once a cash basis farmee exercises their right to acquire the interest in the mining tenement, the farmee may claim input tax credits to the extent of any consideration already provided. If a cash basis farmee provides further consideration after they have exercised their right, the input tax credit with respect to that further consideration is attributable according to the basic attribution rules.

22. The following examples illustrate how the attribution rules under this legislative instrument apply in conjunction with the basic rules under Division 29.

Example

23. A farmor and farmee have entered into a deferred transfer farm-out and MT 2011/D2 applies to the arrangement.

24. The farmor grants the farmee a right to acquire an interest in the mining tenement for $1,100 (GST inclusive). The farmor is required to transfer a 25% interest in a mining tenement to the farmee if the farmee carries out exploration work to the value of $880,000 (GST inclusive) over a 3 year period and upon exercise of the right to acquire the interest in the mining tenement makes a cash payment to the farmor of $11,000 (GST inclusive).

25. The market value of the interest in the mining tenement is $110,000 (GST inclusive) at the time of entering into the agreement. Based on the principles in MT 2011/D2 the value of the exploration benefits the farmor receives is $97,900 (including GST of $8,900). This is worked out as $110,000[10] less $11,000[11] cash payment upon exercise of the option less $1,100[12] which for GST purposes was consideration for the granting of the right.

26. The following transpires in relation to the interest in the mining tenement:

- tax period 1, year 1 - the farmee commences exploration work and thus commences providing exploration benefits to the farmor.
- tax period 3 in year 3 - the exploration work is completed and the provision of exploration benefits is completed.
- tax period 4 in year 3 - the farmee exercises the right to acquire the agreed interest in the mining tenement and pays the farmor $11,000.
- tax period 1 in year 4 - the interest in the mining tenement is transferred to the farmee from the farmor.

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[9] The farmee must hold a tax invoice to claim an input tax credit: subsection 29-10(3).
[10] The GST inclusive market value of the interest in the mining tenement.
[11] The GST inclusive cash payment.
[12] The amount of $1,100 is deducted because, upon the exercise of the right to acquire the interest in the mining tenement, the consideration for the exploration benefit is limited to any additional consideration that is provided (see subparagraph 9-15(3)(a)(i)). The GST payable and input tax credits on $1,100 are attributed according to the basic attribution rules see paragraphs 80 and 236 and 237 of MT 2011/D2.

Farmor – cash basis	**Farmor – non-cash basis**
$8,900 GST payable Under the legislative instrument the GST payable is attributable to tax period 1, year 4 and not the earlier tax periods in which the exploration benefits were received. $1,000 GST payable Under the basic rules (s29-5(2)(a)) the GST payable is attributable to tax period 4, year 3 as this is the tax period in which the monetary consideration is received. $8,900 input tax credit Under the basic rules (s29-10(2)(a)) the input tax credit is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. all of the consideration) is provided by the farmor. The farmor would also need to hold a tax invoice (s29-10(3)) issued by the farmee to claim an input tax credit in this tax period. *Net outcome* Legislative instrument - $8,900 GST payable in tax period 1, yr 4 Basic rules - $8,900 input tax credit claimable in tax period 1, yr 4 provided a tax invoice is held in that tax period Basic rules - $1,000 GST payable in tax period 4, yr 3	$8,900 GST payable $1,000 GST payable Under the legislative instrument the GST payable is attributable to tax period 4, year 3 and not the first (earlier) tax period in which the exploration benefits commenced being received. $8,900 input tax credit Under the basic rules (s29-10(1)(b)) the input tax credit is attributable to tax period 4, year 3 if the farmee issues the farmor with an invoice in this tax period. If not the input tax credit is attributable (s29-10(1)(a)) to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. any of the consideration) is provided by the farmor. The farmor would also need to hold a tax invoice (s29-10(3)) issued by the farmee to claim an input tax credit in either tax period. *Net outcome* Legislative instrument - $8,900 GST payable in tax period 4, yr 3 Legislative instrument - $1,000 GST payable in tax period 4, yr 3 Basic rules - $8,900 input tax credit claimable in tax period 4, yr 3; or tax period 1, yr 4; provided a tax invoice is held in that tax period
Farmee – cash basis	**Farmee – non-cash basis**
$8,900 GST payable Under the basic rules (s29-5(2)(a)) the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. all of the consideration) is received by the farmee. $9,900[13] input tax credit Under the legislative instrument the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (s29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply. *Net outcome* Basic rules - $8,900 GST payable in tax period 1, yr 4 Legislative instrument - $9,900 input tax credit claimable in tax period 4, yr 3 provided a tax invoice is held in that tax period	$8,900 GST payable Under the basic rules (s29-5(1)(a)) the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. any of the consideration) is received by the farmee. However, if the farmee issues an invoice in an earlier tax period, for example, in tax period 4, year 3, the GST payable is attributable to this earlier tax period (s29-5(1)(b)). $9,900 input tax credit Under the legislative instrument the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (s29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply. *Net outcome* Basic rules - $8,900 GST payable in tax period 1, yr 4; or, tax period 4, yr 3 Legislative instrument- $9,900 input tax credit claimable in tax period 4, yr 3 provided a tax invoice is held in that tax period

[13] That is, $8,900 plus $1,000.

Background

27. This instrument is being developed to ensure that the attribution rules apply appropriately for a farmor entity that makes a taxable supply of an interest in a mining tenement and a farmee entity that makes a creditable acquisition of that interest under a deferred transfer farm-out arrangement as characterised in the draft Ruling MT 2011/D2.

Costing

28. [to be completed]

Consultation

29. Consultation on the draft instrument and draft explanatory statement is being undertaken as part of consultation on the related draft Ruling MT 2011/D2.

30. In particular, comments are sought on whether, in the context of a deferred transfer farm-out arrangement as set out in MT 2011/D2:

- the rules as drafted in the proposed legislative instrument result in appropriate outcomes for the farmor and the farmee and if not why not;
- the basic attribution rules otherwise result in appropriate outcomes for the farmor and the farmee and if not why not.

31. The instrument, explanatory statement and draft Ruling MT 2011/D2 are relevant to the mining and petroleum industries.

[Additional comments may be added following consultation.]

[insert name]
Deputy Commissioner of Taxation

[date of issue]

Legislative references:
A New Tax System (Goods and Services Tax) Act 1999
Legislative Instruments Act 2003