MT 2011/D2 - Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements

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This document has been finalised by MT 2012/2.

There is a Compendium for this document: **MT 2012/2EC** .

A draft legislative instrument proposes attribution rules to apply in place of the basic attribution rules for the farmor (in respect of GST payable) and the farmee (in respect of input tax credits) in particular circumstances under a deferred transfer farm-out arrangement.
Due to the connection between the draft Miscellaneous Taxation Ruling MT 2011/D2 and the proposed legislative instrument, the draft legislative instrument and the draft explanatory statement have been released for comment in conjunction with the publication of MT 2011/D2.

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Draft Miscellaneous Taxation Ruling

Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements

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Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

What this Ruling is about

1. This draft Ruling sets out the Commissioner's views on the application of the income tax and goods and services tax (GST) provisions upon entry into a deferred transfer farm-out arrangement as described in paragraph 14 of this draft Ruling.[1]

2. In particular, for income tax purposes, the draft Ruling explains the application of the following provisions to deferred transfer farm-out arrangements:

- the capital gains tax (CGT) provisions;[2]
- the uniform capital allowance (UCA) provisions;[3] and
- sections 6-5, 8-1 and 15-40 of the ITAA 1997.

[1] For the income tax law, a reference to the *Income Tax Assessment Act 1997* is referred to as the ITAA 1997; a reference to the *Income Tax Assessment Act 1936* is referred to as the ITAA 1936. For the GST law, a reference to the *A New Tax System (Goods and Services Tax) Act 1999* is referred to as the GST Act.
[2] See Part 3-1 of the ITAA 1997.
[3] See Division 40 of the ITAA 1997.

3. This draft Ruling does not discuss the application of the income tax and GST provisions to:

- an immediate transfer farm-out arrangement. An immediate transfer farm-out arrangement is discussed in Miscellaneous Taxation Ruling MT 2011/D1;[4] or
- a joint venture arrangement that is in existence or that may be formed at the time of the transfer of the interest in the mining tenement to the farmee under a deferred transfer farm-out arrangement.

Background

4. Farm-out arrangements are common in the mining and petroleum industries. Broadly speaking, they are arrangements entered into for the purpose of facilitating exploration for the discovery of minerals and petroleum resources.

5. A typical arrangement provides for the owner of an interest in a mining tenement[5] (the 'farmor') to transfer a percentage of that interest to another party (the 'farmee') if the farmee meets specified exploration commitments. The arrangement may also provide for monetary payments by the farmee to the farmor either directly or indirectly.

6. Often the commercial driver for such an arrangement from the farmor's perspective is funding. That is, 'the farmor giving up future economic benefits, in the form of reserves, in exchange for a reduction in future funding obligations'[6]. For the farmee, it provides an opportunity to acquire an interest in a mining tenement.[7]

7. Broadly, farm-out arrangements may be divided into two types of farm-out arrangements, referred to as 'immediate transfer' and 'deferred transfer' farm-out arrangements.[8] The following are broad descriptions as immediate and deferred transfer farm-out arrangements will necessarily reflect the particular terms agreed to by the parties.

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[4] Miscellaneous taxes: application of the income tax and GST laws to immediate transfer farm-out arrangements.
[5] The term 'mining tenement' is used throughout this draft Ruling as a reference to a *mining, quarrying or prospecting right* as defined in subsection 995-1(1) of the ITAA 1997.
[6] Mining and Metals Refining IFRS, May 2009, available at www.ey.com.au.
[7] Birch, Charles, 'Choosing the Right Joint Venture Structure for a Farmin or Farmout' [2002] JIATax 3; (2002) 5 (1) Journal of Australian Taxation 60.
[8] Birch, Charles, 'Choosing the Right Joint Venture Structure for a Farmin or Farmout' [2002] JIATax 3; (2002) 5 (1) Journal of Australian Taxation 60.

Deferred transfer farm-out arrangement

8. Under a deferred transfer farm-out arrangement, the terms of the arrangement specify that the transfer of the interest in the mining tenement from the farmor to the farmee occurs only after the farmee has met all of the exploration commitments and any payment requirements to earn that interest (collectively referred to as the earn-in requirements) within a specified period of time (the earn-in period).

9. Certain exploration commitments or payments may be mandatory upon entering into the agreement. However, most (if not all) of the exploration commitments and payments are at the discretion of the farmee. Monetary payments (if any) may be made upon entering into the agreement, while the agreement is on foot or at a later stage when the right to acquire the interest in the mining tenement is exercised or upon transfer of the interest to the farmee. The farmee may also be subject to other conditions during the earn-in period and while the agreement is on foot, such as enabling the farmor to comply with the requirements of the relevant Act[9] applicable to the grant of the mining tenement and providing updates as to exploration expenditure and results. Thus, the farmee's expenditure typically results, at least to some extent, in the farmor meeting its minimum expenditure commitments under the relevant Act, for example, the Mineral Resources Act 1989 (QLD).

10. The farmee is able to terminate the agreement at any time (save perhaps for an initial period such as the first 12 months) provided the mining tenement is in good order at the time of giving notice to terminate to the farmor. If the farmee does not satisfy the earn-in requirements during the earn-in period, the farmee does not earn the specified interest in the mining tenement.

11. To facilitate the farmee satisfying the earn-in requirements, the farmor grants to the farmee a right to exclusive use and access of the mining tenement. The farmor also typically provides access to any mining information it has. If the farmee does earn the specified interest in the mining tenement, the farmee becomes a holder of that interest in the mining tenement. The farmor is left with a reduced percentage interest in the mining tenement.

12. The agreement is usually subject to other conditions imposed on both the farmor and farmee. For example, the farmee will typically covenant to comply with relevant laws and the farmor will typically covenant that it has sufficient interest in the mining tenement to meet its obligation, should it arise, to transfer the earned interest to the farmee. The agreement will also typically deal with seeking the permission or agreement of the relevant authority for the transfer of the interest.

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[9] For example, the *Mineral Resources Act 1989* (Qld).

Immediate transfer farm-out arrangement

13. To contrast, under an immediate transfer farm-out arrangement, an obligation to transfer a percentage interest in a mining tenement from a farmor to a farmee arises for the farmor upon entry into the farm-out agreement. In return for the transfer of the interest in the mining tenement, the farmee will undertake exploration commitments and may also undertake to make cash payments to, or on behalf of, the farmor. Typically, the farmor and farmee will also establish a joint venture or, if a joint venture is already in existence, the farmee will become a joint venturer along with the other parties to the joint venture arrangement. The income tax and GST consequences for an immediate transfer farm-out arrangement are discussed in draft Miscellaneous Taxation Ruling MT 2011/D1.

Class of arrangement/scheme

14. The deferred transfer farm-out arrangements covered by this draft Ruling have the following characteristics:

The farmor	*The farmee*
• Provides the farmee with a right (akin to an option) to acquire an interest in the mining tenement by satisfying the earn-in requirements over the earn-in period. • Provides the farmee with exclusive use and access rights (akin to a licence). • May share mining information with the farmee. • Transfers a percentage interest in the mining tenement to the farmee at the end of the earn-in period if the farmee exercises the right to acquire the interest in the mining tenement (and all necessary approvals[10] are granted). This leaves the farmor with a reduced percentage interest in that mining tenement.[11]	• Undertakes exploration commitments, which may be referrable to a period of time; an amount(s); a schedule of works; or a combination thereof. Under the terms of the agreement, the exploration commitments may to some extent be mandatory but most, if not all, of the exploration commitments will be at the discretion of the farmee. • May make cash payments to the farmor. These payments may or may not be referrable to the exploration costs the farmor has incurred prior to the farm-out arrangement being entered into. Payment(s) may also be made at the time of exercising the right to acquire the interest or upon transfer of the interest. • May make cash payments on behalf of the farmor to other parties.

[10] For example, Ministerial or Foreign Investment Review Board approval.
[11] The parties would typically enter into a joint venture arrangement, or the farmee would become a joint venturer if such an arrangement already exists.

15. This draft Ruling does not apply to deferred transfer farm-out arrangements that have materially different features to those set out in paragraph 14 of this draft Ruling. As it is not possible to comprehensively deal with the multitude of ways in which a deferred transfer farm-out arrangement may be structured, you may need to seek a private ruling if your arrangement is not comparable to that discussed in this draft Ruling.

Ruling

Characterisation of the arrangement

16. Paragraphs 17 to 34 of this draft Ruling set out how a deferred transfer farm-out arrangement covered by this draft Ruling is characterised. If these views do not hold true, the conclusions reached in this draft Ruling in relation to the application of the income tax and GST provisions will also not hold true.

The right to acquire an interest in a mining tenement

17. Upon entering into a deferred transfer farm-out agreement, the farmor grants to the farmee a right (akin to an option) to acquire an interest in a mining tenement. The farmee's exercise of that right is subject to the farmee satisfying the earn-in requirements within the earn-in period.

18. The grant of the right (option) to acquire an interest in the mining tenement is often in return for a nominal cash payment, although this may vary and will necessarily depend on the terms of the agreement.

19. The grant of the right to acquire an interest in the mining tenement is treated in this draft Ruling as being on capital account.[12]

The exclusive use and access rights

20. The farmor grants exclusive use and access rights (akin to a licence) to the farmee to facilitate the farmee carrying out the exploration commitments.

[12] This is discussed further at paragraphs 118 to 120 of this draft Ruling.

21. The consideration for the grant of these rights will depend upon the terms of the agreement. However, the approach under this draft Ruling is to treat cash payments[13] that are required to be made by a farmee either to, or on behalf of, the farmor while the agreement is on foot, as being in return for the grant of these rights. Thus, consideration for the grant of these rights includes cash payments to the farmor or to other parties such as the payment of fees, rates and other charges that are incurred by the farmor but are met by the farmee while the agreement is on foot.

22. This approach effectively recognises a correlation between the ongoing use and enjoyment of the exclusive use and access rights and the ongoing requirement to make such payments either to the farmor, or on the farmor's behalf, until the farmee either:

- opts to discontinue carrying out the exploration commitments (in which case the earn-in requirements are not satisfied and there is no transfer of the interest in the mining tenement); or
- satisfies the earn-in requirements and exercises the right to acquire the interest in the mining tenement.

23. The grant of the exclusive use and access rights is treated in this draft Ruling as being on revenue account.[14]

Allocation and apportionment

24. The allocation and apportionment of payments between the rights to acquire an interest in mining tenement and the exclusive use and access rights necessarily depends on the terms of the arrangement and any other relevant facts and circumstances.

25. The apportionment of such payments as between these rights will have particular implications for income tax and GST[15] purposes.[16]

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[13] This would not include any payments that are for the interest in the mining tenement and made upon exercise of the right to acquire the interest or upon transfer of the interest.

[14] This is discussed further at paragraphs 121 to 124 of this draft Ruling.

[15] For GST purposes, apportionment between the two supplies is relevant if, for example, the farmor or the farmee accounts for GST on a non-cash basis and the consideration for the supply of the right to acquire an interest is known and the basic attribution rules apply, but the consideration for the supply of the rights to exclusive use and access is unknown and a legislative instrument applies for attribution purposes. Practically, however, it may not be of significance.

[16] This is discussed further at paragraphs 125 and 126 of this draft Ruling.

Mining information

26. Mining information[17] shared by the farmor with the farmee on entering into the arrangement is treated as separate to the rights granted by the farmor, if the parties have identified consideration provided by the farmee as being for that information. The sharing of mining information in these circumstances is the provision of a service by the farmor to the farmee.

27. However, if the sharing of mining information is merely to facilitate the farmee's exploration of the mining tenement, and consequently separate consideration has not been identified for it, the farmor's sharing of that information with the farmee is merely incidental to the rights granted by the farmor on entering into the arrangement rather than the provision of a service. In this case, the farmor's sharing of mining information with the farmee will not give rise to additional income tax or GST consequences.

28. The farmee's sharing of mining information from its exploration work with the farmor will not give rise to additional income tax or GST consequences if it is merely a part of the exploration benefits.[18]

Transfer of the interest in the mining tenement

29. If the farmee satisfies the earn-in requirements and exercises the right to acquire an interest in the mining tenement (and all necessary approvals are granted), there is a transfer of the agreed percentage interest in the mining tenement by the farmor to the farmee. This leaves the farmor with a reduced percentage interest in that mining tenement.

30. In return for the transfer of the interest in the mining tenement, the farmor receives, or has received, benefits that flow to it from the farmee's exploration commitments. In this draft Ruling, these benefits are referred to as 'exploration benefits'. The farmee may also make a payment(s) to, or on behalf of, the farmor for the interest in the mining tenement upon exercise of the right to acquire the interest or upon transfer of the interest.

31. The farmee's provision of exploration benefits to the farmor is for reward to the extent that the transfer of the interest in the mining tenement is in return for the provision of those exploration benefits. The draft Ruling proceeds on the basis that the exploration benefits are the provision of a service by the farmee on revenue account. If this does not hold true in the farmee's particular circumstances, the conclusions reached in this draft Ruling in relation to the application of the income tax provisions will also not hold true.[19]

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[17] The term 'mining information' is used throughout this draft Ruling as a reference to *mining, quarrying or prospecting information* as defined in subsection 995-1(1) of the ITAA 1997.
[18] This is discussed further at paragraphs 127 to 129 of this draft Ruling.
[19] This is discussed further at paragraphs 130 to 136 of this draft Ruling.

No transfer of the interest in the mining tenement

32. If the farmee does not satisfy the earn-in requirements, or does not exercise the right to acquire an interest in the mining tenement, there is no transfer of the interest by the farmor to the farmee. The farmor has, however, still received exploration benefits from the farmee to the extent that the farmee has undertaken some of the exploration commitments. The exploration benefits are a non-cash business benefit to the farmor.[20]

Market valuation

33. If the parties are dealing with each other at arm's length, it is accepted that the market value of the exploration benefits that flow to the farmor, and any cash payments made to, or on behalf of, the farmor in return for the transfer of the interest in the mining tenement, is equal to the market value of the interest in the mining tenement and any other benefits that are provided by the farmor.[21] The value of the exploration benefits to the farmor does not necessarily equate with the amount to be spent by the farmee on exploration work.

34. In the context of these arrangements, the relevant time for determining the market value of the interest in the mining tenement that is transferred by the farmor and any other non-cash benefits, is at the time of entering into the farm-out agreement. The market valuation must take into account all the facts and surrounding circumstances.[22]

Application of the income tax provisions

35. Based on the characterisation of a deferred transfer farm-out arrangement as set out in paragraphs 17 to 34 of this draft Ruling, the income tax consequences for the following transactions are explained:

- the grant of the right to acquire an interest in the mining tenement (paragraphs 36 to 39 of this draft Ruling);
- the grant of exclusive use and access rights (paragraphs 40 to 45 of this draft Ruling);
- the sharing of mining information (paragraphs 46 and 47 of this draft Ruling);

[20] This is discussed further at paragraphs 141 to 143 of this draft Ruling.
[21] This is consistent with the view the Commissioner takes in Goods and Services Tax Ruling *GSTR 2001/6: non-monetary consideration* (paragraphs 19 and 138).
[22] This is discussed further at paragraphs 144 to 156 of this draft Ruling.

- the transfer of the interest in the mining tenement by the farmor; the provision of exploration benefits by the farmee (paragraphs 48 to 72 of this draft Ruling); and
- the provision of exploration benefits but no transfer of any interest in the mining tenement (paragraphs 73 to 77 of this draft Ruling).

Grant of the right to acquire an interest in the mining tenement

Consequences for the farmor

36. The farmor granting a right (akin to an option) to the farmee to acquire an interest in a mining tenement results in CGT event D2[23] happening to the farmor.

37. The capital proceeds are the money the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the right.[24]

Consequences for the farmee

38. The farmee acquires a CGT asset, being the right to acquire an interest in the mining tenement. The amount paid by the farmee for the right to acquire the interest in the mining tenement is included in the cost base of the right.

39. Upon the ending of the right to acquire the interest, CGT event C2[25] happens to the farmee. If the cost of the right is not deductible to the farmee, the farmee will make a capital loss equal to the cost base of that right. The capital loss is made in the income year in which the ending of the right occurs.[26]

Grant of exclusive use and access rights

Consequences for the farmor

40. On the basis that the grant by the farmor to the farmee of exclusive use and access rights is on revenue account,[27] the payments[28] paid to, or on behalf of, the farmor in return for the grant of those rights are assessable income of the farmor under section 6-5 of the ITAA 1997. The payments are assessable income in the income year in which the payments are derived.

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[23] Section 104-40 of the ITAA 1997.
[24] Section 116-20 of the ITAA 1997. This is discussed further at paragraphs 158 and 159 of this draft Ruling.
[25] Section 104-25 of the ITAA 1997.
[26] This is discussed further at paragraphs 160 and 161 of this draft Ruling.
[27] Examples 3 and 4 at paragraphs 267 and 272 respectively proceed on this basis.
[28] See paragraph 21 of this draft Ruling.

41. The grant of the exclusive use and access rights also results in CGT event D1 happening to the farmor when the farmor grants the right.[29] However, as the reward for the grant of the rights is on revenue account for the farmor, section 118-20 of the ITAA 1997 reduces any capital gain made under CGT event D1 that is otherwise included in assessable income.

42. The capital proceeds are the money the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the exclusive use and access rights.[30]

43. The fees, rates and charges or other expenses incurred by the farmor for the maintenance of the mining tenement are deductible under section 8-1 of the ITAA 1997 if the requirements of that section are satisfied. The deduction is allowed in the income year in which the expenses are incurred.[31]

Consequences for the farmee

44. The farmee can deduct expenditure on the exclusive use and access rights under section 8-1 of the ITAA 1997 if the requirements of section 8-1 of the ITAA 1997 are satisfied. The deduction is allowed in the income year in which the expenditure is incurred.[32]

45. Upon the ending of the exclusive use and access rights, CGT event C2 happens to the farmee. If the cost of the rights is not deductible to the farmee, the farmee will make a capital loss equal to the cost base of the rights. The capital loss is made in the income year in which the ending of the rights occurs.[33]

Sharing mining information

Consequences for the farmor

46. If the parties have identified any consideration provided by the farmee as being for mining information shared[34] by the farmor with the farmee on entering into the arrangement, the consideration is assessable income of the farmor under section 6-5 or section 15-40 of the ITAA 1997. It is assessable income of the farmor in the income year in which it is derived (section 6-5 of the ITAA 1997) or received (section 15-40 of the ITAA 1997).[35]

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[29] Section 104-35 of the ITAA 1997.
[30] This is discussed further at paragraphs 162 and 163 of this draft Ruling.
[31] This is discussed further at paragraph 219 of this draft Ruling.
[32] This is discussed further at paragraph 220 of this draft Ruling.
[33] This is discussed further at paragraphs 164 and 165 of this draft Ruling.
[34] That is, the farmor continues to hold that mining information.
[35] This is discussed further at paragraph 213 to 215 of this draft Ruling.

Consequences for the farmee

47. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee, then:

- the farmee is entitled to a deduction for expenditure incurred if the information obtained is mining, quarrying or prospecting information associated with searching for and evaluating areas containing minerals or quarry materials;[36]
- the farmee is entitled to that deduction under subsection 40-730(1) of the ITAA 1997 subject to subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying; and
- the deduction is allowed in the income year in which the expenditure is incurred.[37]

Transfer of the interest in the mining tenement by the farmor; provision of exploration benefits by the farmee

Consequences for the farmor

UCA – balancing adjustment event

48. A balancing adjustment event occurs for the interest in the mining tenement transferred by the farmor when the farmee begins to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997. When the farmee begins to hold the interest in the mining tenement under this item is explained further at paragraphs 61 and 62 of this draft Ruling.

49. A balancing adjustment amount is included in the farmor's assessable income if the termination value of the interest in the mining tenement that is transferred by the farmor is more than its adjustable value just before the event occurred.

50. The adjustable value of the interest in the mining tenement transferred by the farmor is a reasonable proportion of the adjustable value of the interest in the mining tenement before it was split into two assets[38] along with a reasonable proportion of any other capital costs involved in splitting the asset.[39]

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[36] See paragraph 40-730(4)(d) of the ITAA 1997.
[37] This is discussed further at paragraph 212 of this draft Ruling.
[38] The two assets being the interest the farmor retains and the interest the farmor transfers to the farmee.
[39] Section 40-205 of the ITAA 1997.

51. The termination value of the interest in the mining tenement transferred by the farmor is the sum of:

- any payments made by the farmee, to or on behalf of, the farmor or the amount of the farmor's right to receive such amounts for the transfer of the interest;[40] and
- the market value of the exploration benefits, or the rights to those benefits, that flow to the farmor.[41]

52. The termination value also includes the amount of the capital proceeds received under CGT event D2 for the grant of the right to acquire the interest in the mining tenement.[42] (See paragraphs 59 and 60 of this draft Ruling which explain the CGT and UCA interaction).[43]

UCA – exploration or prospecting expenditure deductions

53. The interest in the mining tenement that the farmor transfers to the farmee is in return for exploration or prospecting and to that extent the transfer of the interest secures exploration benefits for the farmor.

54. The farmor is therefore entitled to a deduction under subsection 40-730(1) of the ITAA 1997 subject to subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying.

55. If subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply, the deduction is allowed in the income year in which the expenditure is incurred. That is, the income year in which farmee exercises the right to acquire the interest in the mining tenement.[44]

56. Subsection 40-730(2) of the ITAA 1997 applies if the expenditure is on the following activities:

- development drilling for petroleum; or
- operations in the course of working a mining property, quarrying property or petroleum field.

57. Whether it is expenditure on an activity listed under subsection 40-730(2) of the ITAA 1997 will necessarily depend on the particular facts and circumstances.

58. Subsection 40-730(3) of the ITAA 1997 applies if the expenditure forms part of the cost of a depreciating asset.[45]

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[40] See items 1 and 3 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[41] See items 4 and 6 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[42] See item 1 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[43] This is discussed further at paragraphs 175 to 183 of this draft Ruling.
[44] The draft Ruling assumes an accruals basis.
[45] This is discussed further at paragraphs 1884 to 1956 of this draft Ruling.

CGT – CGT events D2 and A1 disregarded

59. CGT event D2[46] happened to the farmor upon the farmor granting the right to the farmee to acquire an interest in the mining tenement (see paragraph 36 of this draft Ruling). However, if there is a transfer of the interest in the mining tenement by the farmor to the farmee (CGT event A1), the capital gain or capital loss made by the farmor under CGT event D2 is disregarded.[47] The capital proceeds for the grant of that right that would have been included in working out any capital gain or loss made under CGT event D2 are included in the capital proceeds for CGT event A1.[48]

60. CGT event A1 happens[49] to the farmor for the interest in the mining tenement that is transferred by the farmor to the farmee.[50] However, subsection 118-24(1) of the ITAA 1997 applies to disregard any capital gain or loss made on the transfer of the interest in the mining tenement if the decline in value of the interest in the mining tenement is, (or would be, if it was used), worked out under the UCA provisions. This is subject to the exclusions set out in subsection 118-24(2) of the ITAA 1997, which are not considered relevant to these circumstances. The capital proceeds under CGT event A1 (including those under CGT event D2) are included in the termination value of the interest in the mining tenement as these are amounts that the farmor is taken to have received under a balancing adjustment event.[51]

Consequences for the farmee

UCA – decline in value deduction for the interest in the mining tenement

61. The farmee begins to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the farmee exercises the right to acquire the interest and is able to exercise rights[52] in relation to the interest in the mining tenement and there is a reasonable expectation that legal ownership will transfer to the farmee. Whether this is the case will necessarily depend on the particular facts and circumstances.

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[46] Section 104-40 of the ITAA 1997.
[47] Subsection 104-40(5) of the ITAA 1997.
[48] Section 116-65 of the ITAA 1997.
[49] See subsection 104-10(3) of the ITAA 1997 as to when the event happens.
[50] Section 104-10 of the ITAA 1997.
[51] Paragraph 40-305(1)(b) of the ITAA 1997. This is discussed further at paragraphs 166 to 169 and 182 and 183 of this draft Ruling.
[52] For example, to explore the mining tenement or to become a joint venture participant (whereby the joint venture operator acts on behalf of the farmee and the other participants in exploring the tenement) or to become the joint venture operator (thus acting on its own behalf as well as other participants).

62. However, the fact that completion of the agreement is conditional (for example on Ministerial approval) does not prevent the farmee from beginning to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the farmee exercises the right to acquire the interest.[53]

63. There is no further balancing adjustment event when the farmee becomes the legal owner of the interest in the mining tenement under item 10 of the table in section 40-40 of the ITAA 1997.[54]

64. The first element of cost of the interest in the mining tenement is the same amount as the farmor's termination value of that interest.[55]

65. The farmee is entitled to a decline in value deduction for the first element of cost of the interest in the mining tenement to the extent it is used for a taxable purpose.[56]

66. If the farmee's first use of the interest in the mining tenement after the farmee begins to hold it is for exploration or prospecting, the farmee's decline in value deduction is the cost of the interest.[57] That is, the farmee is entitled to an immediate deduction for the cost of the interest. The deduction is allowed in the income year in which the start time for the interest in the mining tenement occurs.[58] That is, the income year in which the interest in the mining tenement is first used for exploration or prospecting.

67. The question of whether the farmee's first use of the interest in the mining tenement is for exploration or prospecting, after the farmee begins to hold it, necessarily depends on the particular facts and circumstances.[59]

68. If it is not first used for exploration or prospecting, then the farmee is entitled to an annual decline in value deduction for the interest in the mining tenement under section 40-25 of the ITAA 1997.

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[53] This is discussed further at paragraphs 198 and 199 of this draft Ruling.
[54] This is discussed further at paragraph 200 of this draft Ruling.
[55] See items 1 and 4 of the table in section 40-185 of the ITAA 1997.
[56] See section 40-25 of the ITAA 1997.
[57] The effect of subsection 40-80(1) of the ITAA 1997 as it applies to section 40-25 of the ITAA 1997.
[58] Section 40-60 of the ITAA 1997.
[59] This is discussed further at paragraphs 202 to 209 of this draft Ruling.

UCA – exploration or prospecting expenditure deductions

69. The farmee is entitled to a deduction for expenditure incurred on exploration or prospecting under subsection 40-730(1)[60] of the ITAA 1997 to the extent it does not form part of the cost of a depreciating asset.[61] The deduction is allowed in the income year in which the expenditure is incurred.[62] The discussion in paragraphs 53 to 58 of this draft Ruling as to whether subsection 40-730(2) or 40-730(3) of the ITAA 1997 applies to the farmor also applies to the farmee.

Ordinary income and deduction provisions – farmee's reward for providing exploration benefits

70. To the extent that the interest in the mining tenement received by the farmee is reward for the provision of exploration benefits by the farmee to the farmor, the market value of the interest in the mining tenement is assessable income to the farmee under section 6-5 of the ITAA 1997. It is assessable income in the income year in which the farmee exercises the right to acquire the interest in the mining tenement.

Ordinary income and deduction provisions – farmee's exploration related expenditure

71. If the farmee's expenditure relates to its exploration work and is of a revenue nature but is not exploration or prospecting expenditure for the purposes of subsection 40-730(1) of the ITAA 1997, the expenditure is deductible under section 8-1 of the ITAA 1997 if the requirements of section 8-1 of the ITAA 1997 are satisfied. The deduction is allowed in the income year in which the expenditure is incurred.[63]

CGT consequences for the farmee

72. The farmee acquires a CGT asset, being the interest in the mining tenement. However, aside from this, there are no CGT consequences for the farmee upon the transfer of the interest in the mining tenement.

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[60] This is if all of the other requirements of the provision have been satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply.
[61] Subsection 40-730(3) of the ITAA 1997.
[62] This is discussed further at paragraphs 210 and 211 of this draft Ruling.
[63] This is discussed further at paragraphs 224 and 225 of this draft Ruling.

The provision of exploration benefits but no transfer of any interest in the mining tenement

Consequences for the farmor

73. The exploration benefits that the farmee's exploration work gives rise to are a non-cash business benefit for the farmor.[64] They are a non-cash business benefit that is not convertible to cash and, therefore, it is a benefit to which subsection 21A(1) of the ITAA 1936 applies to treat the benefit as if it were convertible to cash with its value being determined under subsection 21A(2) of the ITAA 1936.

74. However, subsection 21A(3) of the ITAA 1936 can also apply in respect of each income year in which exploration benefits are received by the farmor. The effect of subsection 21A(3) of the ITAA 1936 is to reduce the value of the benefit to the extent that the farmor would have been entitled to a deduction had the farmor incurred and paid unreimbursed expenditure in respect of the provision of the benefit.

75. Thus, on the basis that the farmor would have been entitled to a deduction for such expenditure under subsection 40-730(1) of the ITAA 1997, no amount is returned as assessable income by the farmor in respect of that non-cash business benefit in each relevant income year that such exploration benefits are received. If the availability of a deduction does not hold true in the farmor's particular circumstances, this conclusion will also not hold true.

Consequences for the farmee

76. For the farmee, there is no reward for the farmee's provision of exploration benefits as there is no transfer of the interest in the mining tenement. Therefore, there is no amount assessable to the farmee in return for its provision of the exploration benefits.

77. The farmee may nonetheless be entitled to deductions for expenditure under subsection 40-730(1) or section 8-1 of the ITAA 1997. See further explanation at paragraphs 69 and 71 of this draft Ruling.

Application of the GST provisions

Grant of the right to acquire an interest in the mining tenement and the exclusive use and access rights

78. The grant of the right to acquire an interest in the mining tenement and the grant of exclusive use and access rights are taxable supplies made by the farmor if the requirements of section 9-5 of the GST Act are met. The consideration for these supplies is typically monetary as discussed at paragraphs 18 and 21 of this draft Ruling.

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[64] Non-cash business benefit is defined in subsection 21A(5) of the ITAA 1936.

79. The farmee is entitled to input tax credits if these acquisitions are creditable acquisitions.[65]

80. The GST payable and input tax credits for the farmor and the farmee respectively, are attributable under the basic attribution rules in Division 29 of the GST Act.[66]

81. If total consideration for a supply is not known and the farmor, or the farmee, accounts for GST on a basis other than cash (a 'non-cash basis') the following legislative instrument is relevant – *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000.*[67] For example, it may be relevant to the supply of the exclusive use and access rights if the consideration (or part of it) includes the farmee making cash payments to third parties for fees, rates and other charges while the agreement is on foot. The particular attribution rules in the legislative instrument override the basic attribution rules and the special rules in Chapter 4 of the GST Act but only to the extent of any inconsistency and only to the extent provided for in the legislative instrument.

Mining information

82. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee on entering into the arrangement, the sharing of that information is treated as a supply by the farmor separate from the supply of the interest in the mining tenement. The consideration for the interest in the mining tenement would not include any consideration identified for the mining information.

83. GST payable by the farmor, and any input tax credits able to be claimed by the farmee, are attributable under the basic attribution rules.

Supply of the interest in the mining tenement and acquisition of the exploration benefits by the farmor

GST payable

84. The supply of the interest in the mining tenement is a taxable supply if the requirements of section 9-5 of the GST Act are satisfied. The consideration for the supply is the exploration benefits provided by the farmee along with any monetary payments upon exercise of the right to acquire the interest or upon transfer of that interest.

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[65] Section 11-5 of the GST Act.
[66] The basic attribution rules are explained at paragraphs 13 to 40 of Goods and Services Tax Ruling GSTR 2000/29 Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25 of the GST Act.
[67] This legislative instrument is available at www.ato.gov.au.

85. A draft legislative instrument[68] proposes attribution rules to ensure that the attribution of GST payable on the taxable supply of the interest in the mining tenement occurs as follows:

(i) *if the farmor accounts for GST on a non-cash basis* - GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire the interest. This applies to both monetary and non-monetary consideration for the supply of the interest in the mining tenement; and

(ii) *if the farmor accounts for GST on a cash basis* - GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the interest is transferred to the extent that the consideration received for that supply is exploration benefits.

86. The attribution rules in the draft 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.

87. A farmor that accounts for GST on a cash basis attributes the GST payable on any monetary consideration received for the taxable supply of the interest in the mining tenement to a tax period, to the extent that the monetary consideration is received in that tax period.[69]

Input tax credits

88. The farmor is also entitled to an input tax credit for the acquisition of exploration benefits if it is a creditable acquisition.[70]

89. The basic attribution rules under Division 29 of the GST Act apply to the attribution of input tax credits.

90. The earliest tax period to which the input tax credit could be attributed for a non-cash basis farmor is the tax period in which the farmee, having satisfied the earn-in requirements, exercises the right to acquire the interest in the mining tenement and issues a tax invoice[71] to the farmor. This is the tax period to which GST payable is attributable under the draft legislative instrument (see paragraph 85(i) of this draft Ruling).

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[68] A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2011. This draft legislative instrument along with the draft explanatory statement is available for comment.
[69] Subsection 29-5(2) of the GST Act.
[70] Section 11-5 of the GST Act.
[71] Subsection 29-10(3) of the GST Act.

91. If a farmor accounts for GST on a cash basis the input tax credit is attributable to a tax period to the extent that consideration is provided to the farmee.[72] On this basis the input tax credit is attributable to the tax period in which the interest in the mining tenement is transferred from the farmor to the farmee, assuming the farmee has provided the farmor with a tax invoice. This is the tax period to which GST payable is attributable under the draft legislative instrument (see paragraph 85(ii) of this draft Ruling).

Example 1 – Farmor's attribution of GST payable and input tax credits

92. A farmor and a farmee have entered into a deferred transfer farm-out arrangement of a kind to which this draft Ruling applies.

93. 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).

94. 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 this draft Ruling the value of the exploration benefits the farmor receives is $97,900 (including GST of $8,900). This is worked out as $110,000[73] less $11,000[74] cash payment upon exercise of the option less $1,100[75], which for GST purposes was consideration for the granting of the right.

95. 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; and

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[72] Subsection 29-10(2) of the GST Act.
[73] The GST inclusive market value of the interest in the mining tenement.
[74] The GST inclusive cash payment.
[75] 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) of the GST Act).

- tax period 1 in year 4 - the interest in the mining tenement is transferred to the farmee from the farmor.

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 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(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.	$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 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	*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

Supply of exploration benefits and acquisition of the interest in the mining tenement by the farmee

GST payable

96. The farmee's supply of exploration benefits is a taxable supply if the requirements of section 9-5 of the GST Act are met. The consideration for the farmee's supply is the interest in the mining tenement provided by the farmor.

97. The basic attribution rules under Division 29 of the GST Act apply to the attribution of GST payable.

98. If a farmee accounts for GST on a non-cash basis, the GST payable by the farmee is attributable to the tax period in which the interest in the mining tenement is received by the farmee, unless the farmee issues an invoice to the farmor before this. The earliest tax period in which a farmee could issue an invoice to the farmor is the tax period in which the farmee, having completed the earn-in requirements, exercises the right to acquire the interest in the mining tenement. If an invoice is not issued, the GST payable is attributable to the tax period in which the interest in the mining tenement is transferred from the farmor to the farmee.

99. If a farmee accounts for GST on a cash basis the GST payable by the farmee is attributable to a tax period to the extent that consideration is received in that tax period. On this basis, the GST payable is attributable to the tax period in which the interest in the mining tenement is transferred to the farmee.

Input tax credits

100. The farmee is also entitled to an input tax credit for the acquisition of the interest in the mining tenement if it is a creditable acquisition.

101. The draft legislative instrument[76] proposes attribution rules to ensure that the attribution of an input tax credit for a creditable acquisition of the interest in the mining tenement occurs as follows:

(i) *if the farmee accounts for GST on a non-cash basis* - the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest; and

(ii) *if the farmee accounts for GST on a cash basis* - the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest to the extent of any consideration provided in that tax period or an earlier tax period for that acquisition.

102. The attribution rules in the draft 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. If a cash basis farmee provides further consideration upon the transfer of the interest in the mining tenement, the input tax credit with respect to that further consideration, is attributable in the tax period in which the consideration is provided according to the basic attribution rules.

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[76] A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2011. This draft legislative instrument along with the draft explanatory statement is available for comment.

103. The tax period in which the farmee exercises the right to acquire that interest is the earliest tax period in which the farmor could issue the farmee with a tax invoice.

104. The legislative instrument ensures that the four year time limit[77] 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 making an acquisition, and thus a creditable acquisition, and the farmor can not issue a tax invoice due to a lack of certainty as to any obligation to make a supply.

Example 2 – Farmee's attribution of GST payable and input tax credits

105. Following on from Example 1 at paragraph 92 of this draft Ruling, the following table shows the outcome for a farmee.

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.	$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[78] 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.	$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 Legislative instrument - $9,900 input tax credit claimable in tax period 4, yr 3 provided a tax invoice is held in that tax period	*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

[77] Division 93 of the GST Act.
[78] That is, $8,900 plus $1,000.

Supply of exploration benefits but no supply of the interest in the mining tenement

106. If there is no supply of the interest in the mining tenement by the farmor to the farmee neither the farmor nor the farmee have a GST liability or an entitlement to an input tax credit in relation to the interest in the mining tenement and exploration benefits. It is assumed that the farmee has not made a monetary payment to the farmor for the supply of the interest in the mining tenement as any monetary payment for the supply of the interest would be made upon exercise of the right to acquire the interest or at the time of the transfer of the interest.

107. To the extent that any GST or input tax credits have been accounted for in an earlier tax period the farmor, or the farmee, as appropriate has an adjustment event. An adjustment event may arise if the transfer of the interest in the mining tenement ultimately does not occur because necessary approval (for example, Ministerial approval) is not given to the transfer.

GST going concern

108. Paragraph 195 of GSTR 2002/5[79] explains that it is possible for a joint venturer[80] entity to make a GST-free 'supply of a going concern', including when part of the enterprise conducted by the joint venturer is supplied, providing all of the requirements of section 38-325 of the GST Act, as explained in GSTR 2002/5, are satisfied.

109. If a supply by a joint venturer farmor (which includes the supply of the interest in the mining tenement) is the supply of a going concern that is a GST-free supply under section 38-325 of the GST Act, the farmee will not have any input tax credits to claim and the farmor will have no GST payable in respect of that supply. However, GST is payable by the farmee in respect of its supply of the exploration benefits to the farmor and the farmor may be entitled to input tax credits.

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[79] Goods and Services Tax Ruling *GSTR 2002/5 Goods and services tax: when is a 'supply of a going concern' GST-free?*

[80] For further explanation concerning joint venture arrangements see Goods and Services Tax Ruling *GSTR 2004/2 Goods and services tax: what is a joint venture for GST purposes?*

Summary table

110. The significant income tax and GST consequences for the farmor and farmee upon entering into a deferred transfer farm-out arrangement are summarised in the following table.

Consequences for the farmor…	***Consequences for the farmee…***
Grant of the right to acquire an interest in the mining tenement	
CGT – CGT event D2 happens. (See paragraphs 36 and 37 of this draft Ruling.)	*CGT* – The farmee acquires a CGT asset. (See paragraphs 38 and 39 of this draft Ruling.) If the expenditure on the right (option) to acquire the interest is not deductible, upon the ending of the right, the farmee will make a capital loss under CGT event C2. The capital loss is made in the income year in which the ending of the right occurs.
GST – Farmor makes a taxable supply.[81] GST payable is attributable under the basic attribution rules. (See paragraphs 78 to 81 of this draft Ruling.)	*GST* – Farmee makes a creditable acquisition.[82] To the extent it is for a creditable purpose,[83] the input tax credit is attributable under the basic attribution rules.[84] (See paragraphs 79 to 81 of this draft Ruling.)

[81] This assumes the requirements of section 9-5 of the GST Act are met. This should be assumed throughout this table.
[82] This assumes the requirements of section 11-5 of the GST Act are met. This should be assumed throughout this table.
[83] Section 11-15 of the GST Act.
[84] Under Division 93 of the GST Act, an entitlement to input tax credits for creditable acquisitions may cease if the input tax credits are not included in a GST return within four years from the due date of the GST return for which the credits would have been attributable under subsection 29-10(1) or (2) of the GST Act.

Consequences for the farmor…	***Consequences for the farmee…***
Grant of the exclusive use and access rights	
Income tax – The cash payments[85] that are required to be made by a farmee either to, or on behalf of, the farmor while the agreement is on foot, are in return for the grant of these rights and are assessable income on revenue account in the income year in which the income is derived under section 6-5 of the ITAA 1997. (See paragraph 40 of this draft Ruling.) *Income tax* – The expenditure incurred on fees, rents, rates and other outgoings relating to the maintenance of the mining tenement is deductible under section 8-1 of the ITAA 1997 if the requirements under section 8-1 of the ITAA 1997 have been satisfied. It is deductible in the income year in which the expenditure is incurred. (See paragraph 43 of this draft Ruling.)	*Income tax* – The expenditure incurred by the farmee for the grant of these rights is deductible under section 8-1 of the ITAA 1997 if the requirements under section 8-1 of the ITAA 1997 are satisfied. The expenditure is deductible in the income year in which it is incurred *CGT* - If the expenditure on the exclusive use and access rights is not deductible, upon the ending of the rights the farmee will make a capital loss under CGT event C2. The capital loss is made in the income year in which the ending of the rights occurs. (See paragraphs 44 and 45 of this draft Ruling.)
GST – Farmor makes a taxable supply. GST payable is attributable under the basic attribution rules. However, if the farmor accounts on a non-cash basis and total consideration is not known, the attribution rules in a legislative instrument[86] may apply instead of the basic rules. (See paragraphs 78 to 81 of this draft Ruling.)	*GST* – Farmee makes a creditable acquisition. To the extent it is for a creditable purpose, the input tax credit is attributable under the basic attribution rules. However, if the farmee accounts on a non-cash basis and total consideration is not known, the attribution rules in a legislative instrument may apply instead of the basic rules. (See paragraphs 79 to 81 of this draft Ruling.)

[85] This would not include any payments that are for the interest in the mining tenement and made upon exercise of the right to acquire the interest or upon transfer of the interest.

[86] *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000.*

Consequences for the farmor…	*Consequences for the farmee…*
Transfer of the interest in the mining tenement	
UCA – A balancing adjustment event occurs for the interest in the mining tenement that is transferred by the farmor. The excess of termination value over adjustable value is assessable income in the income year in which the farmee begins to hold the interest in the mining tenement under item 5 in the table in section 40-40 of the ITAA 1997. (See paragraphs 48 to 52 of this draft Ruling.) The termination value includes the capital proceeds under CGT event A1 (which includes capital proceeds under CGT event D2). (See paragraphs 59 and 60 of this draft Ruling.)	*UCA* – There is an immediate deduction for the cost of the interest in the mining tenement if it is first used for exploration or prospecting and the requirements of subsection 40-80(1) and section 40-25 of the ITAA 1997 are satisfied. The deduction is allowed in the income year in which the interest in the mining tenement is first used for exploration or prospecting. (See paragraphs 61 to 68 of this draft Ruling.) There is a deduction under subsection 40-730(1) of the ITAA 1997 for expenditure on exploration or prospecting if all of the requirements of the provision are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply. The deduction is allowed in the income year in which the expenditure is incurred. (See paragraph 69 of this draft Ruling.)
CGT - CGT event A1 also happens but any capital gain or loss is disregarded. (See paragraphs 59 and 60 of this draft Ruling.) The capital gain or loss that was made under CGT event D2 happening upon the grant of the right to acquire an interest in the mining tenement is disregarded. This may mean an amendment to a prior year income tax return.	*CGT* – The farmee acquires a CGT asset. (See paragraph 72 of this draft Ruling.)

Consequences for the farmor…	***Consequences for the farmee…***
UCA – There is a deduction for the farmor under subsection 40-730(1) of the ITAA 1997 to the extent the transfer of the interest in the mining tenement secures exploration benefits for the farmor. The deduction is allowed in the income year in which the farmee exercises the right to acquire the interest in the mining tenement. (See paragraphs 53 to 58 of this draft Ruling.)	*Income tax* – The farmee has assessable income under section 6-5 of the ITAA 1997 to the extent that the interest in the mining tenement is reward for its provision of exploration benefits. The amount is equal to the market value of the interest in the mining tenement, reduced to the extent of any payments by the farmee to, or on behalf, of the farmor for the transfer of the interest in the mining tenement. It is assessable income of the farmee in the income year in which the farmee exercises the right to acquire the interest in the mining tenement. (See paragraph 70 of this draft Ruling.)
GST – Taxable supply of the interest in the mining tenement. Under a proposed legislative instrument, if the farmor accounts for GST: • on a non–cash basis – GST payable is attributable to the tax period in which the farmee exercises the right to acquire the interest; • on a cash basis – GST payable is attributable to the tax period in which the farmor transfers the interest to the farmee to the extent that the consideration received for that supply is exploration benefits. To the extent that the consideration is monetary it is attributed under the basis rules to the tax period in which is it received. (See paragraphs 84 to 87 of this draft Ruling.)	*GST* – Creditable acquisition of the interest in the mining tenement. Under a proposed legislative instrument if the farmee accounts for GST: • on a non–cash basis – the input tax credit is attributable to the tax period in which the farmee exercises the right to acquire the interest; • on a cash basis – the input tax credit is attributable to the tax period in which the farmee exercises the right to acquire that interest to the extent of any consideration provided in that tax period or an earlier tax period for that acquisition. If a cash basis farmee provides further consideration upon the transfer of the interest in the mining tenement, the input tax credit with respect to that further consideration, is attributable in the tax period in which the consideration is provided according to the basic attribution rules (See paragraphs 100 to 104 of this draft Ruling.)

Consequences for the farmor…	***Consequences for the farmee…***
GST – Farmor makes a creditable acquisition of exploration benefits. To the extent it is for a creditable purpose, the input tax credit is attributable under the basic attribution rules. (See paragraphs 88 and 91 and Example 1 at paragraphs 92 to 95 of this draft Ruling.)	*GST* – Taxable supply of exploration benefits. GST payable is attributable under the basic attribution rules. (See paragraphs 96 to 99 and Example 2 at paragraph 105 of this draft Ruling.)
If separate consideration is attributed to the sharing of mining information	
Income tax – The consideration received for the mining information is assessable income for the farmor under section 6–5 or 15-40 of the ITAA 1997, in the income year in which it is derived or received, respectively. (See paragraph 46 of this draft Ruling.)	*UCA* - If the information obtained is associated with searching for and evaluating areas containing minerals or quarry materials, there is a deduction for the farmee's expenditure under subsection 40-730(1) of the ITAA 1997 in the income year in which the expenditure is incurred if all of the requirements of the provision are satisfied and subsections 40-730(2) and 40-730 (3) of the ITAA 1997 do not apply. (See paragraph 47 of this draft Ruling.)
GST – Farmor makes a taxable supply. GST payable is attributable under the basic attribution rules. (See paragraphs 82 and 83 of this draft Ruling.)	*GST* - Farmee makes a creditable acquisition. To the extent it is for a creditable purpose, the input tax credit is attributable under the basic attribution rules. (See paragraphs 82 and 83 of this draft Ruling.)
Farmee withdraws from the arrangement without earning an interest in the mining tenement	
Income tax - The exploration benefits received by the farmor are non-cash business benefits but on the basis that these amounts are otherwise deductible no amount is included in the farmor's assessable income. (See paragraphs 73 to 75 of this draft Ruling.)	*Income tax* – The farmee remains entitled to a deduction under subsection 40-730(1) of the ITAA 1997 for expenditure on exploration or prospecting if all of the requirements of the provision are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply. The deduction is allowed in the income year in which the expenditure is incurred. (See paragraphs 76 and 77 of this draft Ruling.)

Consequences for the farmor…	***Consequences for the farmee…***
GST – No taxable supply of the interest in the mining tenement. No creditable acquisition of the exploration benefits. (See paragraphs 106 and 107 of this draft Ruling.)	*GST* – No taxable supply of exploration benefits. No creditable acquisition of the interest in the mining tenement. (See paragraphs 106 and 107 of this draft Ruling.)

Date of effect

111. This draft Ruling applies to a deferred transfer farm–out agreement[87] dated on or after the issue of this draft Ruling if the farmor started to hold the mining tenement that is the subject of the agreement under a contract entered into on or after 1 July 2001.

112. If the farmor started to hold the mining tenement under a contract entered into before 1 July 2001 Income Tax Ruling IT 2378 is relevant.

113. As the income tax and GST treatment of deferred transfer farm-out arrangements has been the subject of earlier discussion papers that have expressed a different view in some respects to that in this draft Ruling, and the complexity of the issues has resulted in this draft Ruling not being issued earlier, the date of effect is prospective.

114. This draft 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 draft Ruling.

115. The Commissioner invites comments on what, if any, transitional arrangements are appropriate in implementing the final Ruling.

Commissioner of Taxation
24 August 2011

[87] It must be a deferred transfer farm-out arrangement of the type covered by this draft Ruling. See further at paragraph 14 of this draft Ruling.

Appendix 1 – Explanation

116. The Explanation section of this draft Ruling is set out in three Parts:

- **Part A** sets out the Commissioner's approach to these types of arrangements, which is relevant for the application of both the income tax and GST laws (paragraphs 117 to 156 of this draft Ruling);
- **Part B** explains the application of the income tax law to these types of arrangements (paragraphs 157 to 231 of this draft Ruling); and
- **Part C** explains the application of the GST law to these types of arrangements (paragraphs 232 to 266 of this draft Ruling).

Part A – General approach to these arrangements

Characterisation of the arrangement

117. To determine how the income tax and GST laws apply to these arrangements, it is necessary to consider the character of the arrangement between the farmor and the farmee. Paragraph 14 of this draft Ruling sets out the features of a deferred transfer farm-out arrangement covered by this draft Ruling.

The right to acquire an interest in a mining tenement

118. A right to acquire an interest in the mining tenement is granted by the farmor to the farmee upon entering into a deferred transfer farm-out agreement. The farmee's exercise of that right is subject to the farmee meeting the conditions relating to exploration work and any payments.

119. The grant of the right (option) to acquire the interest in the mining tenement is often in return for a nominal cash payment, although this may vary and will necessarily depending on the terms of the agreement.

120. The grant of this right is treated in this draft Ruling as being on capital account.

The exclusive use and access rights

121. The farmor grants exclusive use and access rights (akin to a licence) to the farmee to facilitate the farmee carrying out the exploration commitments.

122. The consideration for the grant of these rights will depend upon the terms of the agreement. However, the approach under this

draft Ruling is to treat cash payments[88] that are required to be made by a farmee either to, or on behalf of, the farmor while the agreement is on foot as being in return for the grant of these rights. Thus consideration for the grant of these rights includes cash payments to the farmor or to other parties such as the payment of fees, rates and other charges that are incurred by the farmor but are met by the farmee while the agreement is on foot.

123. This approach effectively recognises a correlation between the ongoing use and enjoyment of the exclusive use and access rights and the ongoing requirement to make such payments either to the farmor, or on the farmor's behalf, until the farmee either:

- opts to discontinue carrying out the exploration commitments (in which case the earn-in requirements are not satisfied and there is no transfer of the interest in the mining tenement); or
- satisfies the earn-in requirements and exercises the right to acquire the interest in the mining tenement.

124. The reward to the farmor for the grant of exclusive use and access rights is treated in this draft Ruling as being on revenue account. The payments received from the farmee in return for the grant of these rights are the revenue from the exploitation of an asset of the farmor, being the mining tenement it holds.

Allocation and apportionment

125. The allocation and apportionment of payments between the rights to acquire an interest in mining tenement and the exclusive use and access rights necessarily depends on the terms of the arrangement and any other relevant facts and circumstances.

126. The apportionment of such payments as between these rights will have particular implications for income tax and GST[89] purposes.

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[88] This would not include any payments that are for the interest in the mining tenement and made upon exercise of the right to acquire the interest or upon transfer of the interest.

[89] For GST purposes, apportionment between the two supplies is relevant if, for example, the farmor or the farmee accounts for GST on a non-cash basis and the consideration for the supply of the right to acquire an interest is known and the basic attribution rules apply, but the consideration for the supply of the rights to exclusive use and access is unknown and a legislative instrument applies for attribution purposes. Practically, however, it may not be of significance.

Mining information

127. Mining information shared by the farmor with the farmee on entering into the arrangement is treated as separate to the rights granted by the farmor, if the parties have identified consideration provided by the farmee as being for that information. The sharing of mining information in these circumstances is the provision of a service by the farmor to the farmee.

128. However, if the sharing of mining information is merely to facilitate the farmee's exploration of the mining tenement, and consequently separate consideration has not been identified for it, the farmor's sharing of that information with the farmee is merely incidental to the rights granted by the farmor on entering into the arrangement rather than the provision of a service. In this case, the farmor's sharing of mining information with the farmee will not give rise to additional income tax or GST consequences.

129. The farmee's sharing of mining information from its exploration work with the farmor will not give rise to additional income tax or GST consequences if it is merely part of the exploration benefits.

The transfer of the interest in the mining tenement

130. If the farmee satisfies the earn-in requirements and exercises the right to acquire the interest in the mining tenement (and all necessary approvals are granted), there is a transfer of the agreed percentage interest in the mining tenement by the farmor to the farmee. This leaves the farmor with a reduced percentage interest in that mining tenement.

131. In return for the transfer of the interest in the mining tenement, the farmor receives, or has received, benefits that flow to it from the farmee's exploration commitments. In this draft Ruling, these benefits are referred to as 'exploration benefits'. The farmee may also make a payment(s) to, or on behalf of, the farmor for the interest in the mining tenement upon exercise of the right to acquire the interest or upon transfer of the interest.

132. The farmee's provision of exploration benefits to the farmor is for reward to the extent that the transfer of the interest in the mining tenement is in return for the provision of those exploration benefits. The draft Ruling proceeds on the basis that the exploration benefits are the provision of a service by the farmee on revenue account. If this does not hold true in the farmee's particular circumstances, the conclusions reached in this draft Ruling in relation to the application of the income tax provisions will also not hold true.

Exploration benefits that flow to the farmor

133. A reference to the exploration benefits that flow to the farmor from the farmee's exploration commitments does not necessarily equate those benefits with the amount to be spent by the farmee on exploration.

134. It is recognised that, as the farmee is deciding whether or not to exercise the right to acquire the interest in the mining tenement, the exploration commitments are in part for the farmee's own benefit. However, the farmor is also benefiting to some extent from those exploration commitments. In a typical deferred transfer farm-out agreement, the agreement remains on foot while the exploration commitments are being met.

135. Further, the interest in the mining tenement is transferred by the farmor only if the exploration commitments are satisfied and any cash payments required, for example, upon exercise of the right to acquire the interest in the mining tenement, are made. Additionally, the farmee's exploration work satisfies (at least in part if not fully) the farmor's minimum expenditure commitments as holder of the mining tenement or an interest in the mining tenement. The exploration commitments are, or are part of, the consideration that supports the existence of the contract between the parties.

136. To the extent that the farmee's exploration commitments benefit the farmor, the farmor is considered to have received an exploration benefit in the nature of a service from the farmee. A reference in this draft Ruling to the exploration benefits that flow to the farmor is recognition of this.

Alternative view to linking the exploration benefits with the transfer of the interest in the mining tenement

137. It might be argued that if the farmee is obligated to undertake a certain amount of exploration work in an initial period (for example, the first 12 months (mandatory exploration)), the exploration benefits to the farmor as a result of that work is connected with, or reasonably attributable to, the things provided by the farmor to the farmee upon entering into the agreement. It might also be argued that the exploration benefits provided by the farmee to the farmor as a result of the additional (optional) exploration work is also connected with the things provided by the farmor to the farmee upon entering into the agreement.

138. Although these arguments have merit, in the context of these arrangements, there is a closer relationship between the provision of the exploration benefits by the farmee and the transfer of the interest in the mining tenement. The exploration work during the initial period (if there is mandatory exploration work) is part of the total exploration work to be carried out during the earn-in period. The farmee decides as it goes along whether or not to continue and, ultimately, it is the total exploration work with the resulting exploration benefits to the farmor that leads to the farmee exercising its right to acquire the interest in the mining tenement and the farmee and farmor entering into a joint venture.

139. Thus, linking the exploration benefits to the transfer of the interest in the mining tenement is more consistent with the overall purpose of these arrangements and the potential risks and rewards for each party (as discussed at paragraph 155 of this Ruling). That is, the farmor potentially giving up part of the farmor's interest in the mining tenement to secure funding for exploration and the farmee undertaking the exploration to have the opportunity to acquire an interest in the mining tenement.

140. For these reasons, the exploration benefits resulting from any mandatory exploration work as well as the optional exploration work are most appropriately connected with, or reasonably attributable to, the transfer of the interest in the mining tenement rather than the other rights[90] under the agreement which facilitate the main purpose of the agreement.

No transfer of the interest in the mining tenement

141. If the farmee does not satisfy the earn-in requirements, the farmee cannot exercise the right to acquire the interest in the mining tenement. Accordingly, there is no transfer of any interest in the mining tenement by the farmor to the farmee.

142. There is also no transfer of the interest in the mining tenement if, despite having met the earn-in requirements, the farmee nonetheless opts not to acquire the interest in the mining tenement.

143. If the farmee cannot, or does not, exercise the right to acquire an interest in the mining tenement, the farmor has nonetheless received exploration benefits from the farmee to the extent that the farmee has undertaken some of the exploration commitments. The exploration benefits are a non-cash business benefit to the farmor.

[90] That is, the right to acquire the interest in the mining tenement and the exclusive use and access rights.

Market valuation

144. As the farmor receives a non-cash exploration benefit (at least in part) for its transfer of the interest in the mining tenement, it is necessary to consider market value[91] for both UCA and GST purposes.

145. The Commissioner accepts that, if the parties are dealing with each other at arm's length, one way to work out the market value of the exploration benefits provided by the farmee for the interest in the mining tenement is to treat the market value of the exploration benefits that flow to the farmor, and any cash payments made to or on behalf of the farmor by the farmee for the interest, as equal to the market value of the interest that is to be transferred by the farmor and any other benefits that are provided by the farmor.

146. Thus, the value of the exploration benefits to the farmor does not necessarily equate with the amount to be spent by the farmee on exploration work.

147. To put it another way, it is possible to treat the market value of the exploration benefits provided by the farmee to the farmor as equal to the market value of the interest in the mining tenement transferred by the farmor at the time when the farm-out arrangement is entered into, reduced by any cash payments made to or on behalf of the farmor by the farmee for that interest.[92]

Determining the market value

148. Determining market value is a question of objective fact.

149. Market value is worked out on the basis of what a willing but not anxious provider of the thing would agree on with a willing but not anxious acquirer of the thing as payment for it. This may be determined by reference to a hypothetical market.

150. This is based upon the common law test for market value as developed in *Spencer v. The Commonwealth*.[93] The High Court provided a summary of this test in *Abrahams v. FC of T*[94] where Williams J said (at page 29) that market value is:

> the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay… if the vendor and purchaser had got together and agreed on a price in friendly negotiation…

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[91] For GST purposes, it is the GST-inclusive market value of the non-cash benefit. For UCA purposes, Subdivision 27-B of the ITAA 1997 is relevant. It is the GST-inclusive market value for UCA purposes to the extent that the relevant entity cannot claim an input tax credit. For example, if the farmee is entitled to a full input tax credit in relation to the acquisition of an interest in the mining tenement, the relevant amount for UCA purposes would be the GST-exclusive amount.

[92] Excluding any consideration specifically recognised by the parties as being for any mining information provided by the farmor to the farmee (see paragraph 127 of this draft Ruling).

[93] (1907) 5 CLR 418.

[94] (1944) 70 CLR 23.

151. Relevant to the question of valuation are the facts and surrounding circumstances including the terms of the agreement and what is known about the mining tenement at the time of entering into the farm-out agreement. That is, the value of an interest in a mining tenement when little is known about the mining tenement is likely to be different to its value at a later stage of exploration or development when more is known about the mining tenement.

152. For example, the price that a willing but not anxious purchaser might pay at the greenfields stage where there has been no exploration discoveries and, consequently, eventual production from that area is very uncertain, may be minimal.

The time for determining the market value

153. In the context of these arrangements, the relevant time for determining the market value of the interest in the mining tenement that is subsequently transferred by the farmor to the farmee is at the time of entering into the farm-out agreement. Similarly, other non-cash benefits, whether provided by the farmor or the farmee, should be valued at that time. The market valuation must take into account all the facts and surrounding circumstances at that time.

154. The market value of the interest in the mining tenement at the time of entering into the farm-out agreement is considered appropriate on the basis that the farmee's service has a value at the time the arrangement is negotiated and entered into. It is, therefore, reasonable to assume that the value of the farmee's service equates to the value that the interest in the mining tenement has at that time (less any payments to, or on behalf of, the farmor for that interest) rather than at the time of the transfer of the interest to the farmee.[95] No matter what is, or is not, found by way of minerals, the farmor is committed to dispose of the interest in the mining tenement if the farmee meets the earn-in requirements and exercises the right to acquire the interest.

155. The farmee accepts risk in entering into the deferred transfer farm-out arrangement because the farmee undertakes exploration work for its own benefit - work which also benefits the farmor. The farmee may also receive benefits that might arise from an increase in the value of the interest in the mining tenement that it may acquire. Likewise, the farmor accepts risk, including the risk of having to share with the farmee the potential value in the mining tenement.

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[95] This approach is consistent with the ATO's views on that issue in the GST context (see paragraph 160 of GSTR 2001/6). The UCA provisions do not suggest that a different approach is warranted in the context of a deferred transfer farm-out arrangement.

156. In summary, any potential disparity in market value between the market value of the farmee's service, and the market value of the farmor's interest in the mining tenement at the time of transfer by the farmor, could be seen as reward for risk taken by the farmee. It is for this reason that the termination value of the interest in the mining tenement disposed of by the farmor might not be said to equate with the interest's market value at the time of disposal. This is consistent with the fact that the farmor agrees to forgo the percentage interest at a time when the farmor has imperfect knowledge about the worth of the interest.

Part B – Application of the income tax law

157. This Part of the explanation considers:

- the application of the CGT provisions (paragraphs 158 to 171 of this draft Ruling);
- the application of the UCA provisions (paragraphs 172 to 212 of this draft Ruling); and
- the application of sections 6-5, 8-1 and 15-40 of the ITAA 1997 (paragraphs 213 to 231 of this draft Ruling).

The application of the CGT provisions

Grant of the right to acquire an interest in the mining tenement

CGT consequences for the farmor

158. The grant of the right to acquire the interest in the mining tenement by the farmor to the farmee results in CGT event D2[96] happening to the farmor. A capital gain or loss is worked out in accordance with the rules for that event.

159. The capital proceeds are the money the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the right.[97]

CGT consequences for the farmee

160. The farmee acquires a CGT asset, being the right to acquire an interest in the mining tenement. The amount paid by the farmee for the right to acquire the interest in the mining tenement is included in the cost base of the right.

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[96] Section 104-40 of the ITAA 1997.
[97] Section 116-20 of the ITAA 1997.

161. Upon the ending of the right, CGT event C2[98] happens to the farmee. If the cost of the right is not deductible to the farmee, the farmee will make a capital loss equal to the cost base of that right. The capital loss is made in the income year in which the ending of the right occurs.

Grant of exclusive use and access rights

CGT consequences for the farmor

162. The grant of the exclusive use and access rights results in CGT event D1[99] happening to the farmor. As such, any capital gain or loss is worked out in accordance with the rules for that event. However, as the grant of the exclusive use and access rights is treated as being on revenue account,[100] section 118-20 of the ITAA 1997 reduces any capital gain made under CGT event D1 that is otherwise included in assessable income.

163. The capital proceeds are the money the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the exclusive use and access rights.

CGT consequences for the farmee

164. The farmee acquires a CGT asset, being the exclusive use and access rights. The amount paid by the farmee for the exclusive use and access rights is included in the cost base of the rights.

165. Upon the ending of the rights, CGT event C2 happens to the farmee. If the cost of the rights is not deductible to the farmee, the farmee will make a capital loss equal to the cost base of the rights. The capital loss is made in the income year in which the ending of the rights occurs.

Transfer of the interest in the mining tenement to the farmee

CGT consequences for the farmor

166. If the farmee satisfies the earn-in requirements and exercises the right (option) to acquire an interest in the mining tenement, the capital gain (or capital loss) made by the farmor under CGT event D2, upon the grant of the right (option) to acquire the interest in the mining tenement, is subsequently disregarded.[101] CGT event A1[102] happens to the farmor upon disposal of the interest in the mining tenement to the farmee.

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[98] Section 104-25 of the ITAA 1997.
[99] Section 104-35 of the ITAA 1997.
[100] See paragraph 124 of this draft Ruling.
[101] Subsection 104-40(5) of the ITAA 1997. This may mean an amendment to a prior year income tax return.
[102] Section 104-10 of the ITAA 1997.

167. Item 1 of the table in subsection 134-1(1) of the ITAA 1997 refers the grantor of the right (the farmor) to section 116-65 of the ITAA 1997. Under section 116-65 of the ITAA 1997, the capital proceeds received by the farmor for disposal of the interest in the mining tenement under CGT event A1 also includes any payments or property received by the farmor under CGT event D2 for the granting of the right.

168. However, as the interest in the mining tenement is a depreciating asset for the purposes of the UCA provisions, section 118-24 of the ITAA 1997 applies. Therefore, any capital gain or loss made by the farmor as a result of CGT event A1 happening is disregarded.

169. However, the capital proceeds under CGT event A1 (including those under CGT event D2) are included in the termination value of the interest in the mining tenement (see paragraph 183 of this draft Ruling).

CGT consequences for the farmee

170. The farmee acquires a CGT asset being the interest in the mining tenement. However, aside from this, there are no further CGT consequences for the farmee upon the transfer of the interest in the mining tenement.

Interest in the mining tenement is not transferred to the farmee

171. If the interest in the mining tenement is not transferred to the farmee, there are no further CGT consequences for either the farmor or the farmee other than those already explained in paragraphs 158 to 170.

The application of the UCA provisions to the farmor

172. A 'mining, quarrying or prospecting right' is a depreciating asset[103] and includes an interest in the relevant authority, licence, permit, right or lease.[104] The interest in the mining tenement held by the farmor is therefore a depreciating asset.

173. The UCA provisions apply in relation to the interest in the mining tenement that is transferred by the farmor to the farmee. The UCA provisions may also have application to other elements of a deferred transfer farm-out arrangement such as to determine the deductibility of certain expenditure incurred by the farmor and farmee.

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[103] See paragraph 40-30(2)(a) of the ITAA 1997.
[104] See paragraph (c) of the definition of *mining, quarrying or prospecting right* in subsection 995-1(1) of the ITAA 1997.

Grant of the right to acquire an interest in the mining tenement; grant of the exclusive use and access rights to the mining tenement

174. There are no UCA consequences for the farmor upon the grant of the right to acquire the interest in the mining tenement and the grant of the exclusive use and access rights to the mining tenement by the farmor.

Transfer of the interest in the mining tenement

Splitting of the mining tenement

175. When the farmor transfers part of its interest in the mining tenement to the farmee, the farmor's interest is split into two depreciating assets, the interest they retain and the interest they transfer to the farmee.[105]

176. The first element of cost of each of the two depreciating assets, as a result of the split, is worked out under section 40-205 of the ITAA 1997 as being a reasonable proportion of both the adjustable value of the depreciating asset that the farmor held and any other capital costs involved in splitting that depreciating asset.

The occurring of a balancing adjustment event

177. No balancing adjustment event occurs by reason only of the split into the two depreciating assets.[106] A balancing adjustment event does, however, occur for the interest in the mining tenement transferred by the farmor to the farmee.[107]

When the balancing adjustment event occurs

178. A balancing adjustment event occurs for the interest in the mining tenement transferred by the farmor to the farmee when the farmee begins to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997. When the farmee begins to hold the interest under this item is explained further at paragraphs 198 and 199 of this draft Ruling.

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[105] Section 40-115 of the ITAA 1997.
[106] Subsection 40-295(3) of the ITAA 1997.
[107] Subsection 40-295(1) of the ITAA 1997.

Balancing adjustment amount

179. A balancing adjustment amount is worked out for the event under section 40-285 of the ITAA 1997, being the difference between the termination value and adjustable value of the interest in the mining tenement transferred by the farmor. The adjustable value of the interest to the farmor is the amount apportioned to the interest under section 40-205 of the ITAA 1997 (as explained at paragraph 176 of this draft Ruling).

180. The termination value of a depreciating asset is worked out as at the time when the balancing adjustment event occurs.[108] As no item of the table in subsection 40-300(2) of the ITAA 1997 applies to the interest in the mining tenement transferred by the farmor, the termination value of the interest for the farmor is the sum of the applicable amounts set out in the table in paragraph 40-305(1)(b) of the ITAA 1997 that the farmor is taken to have received under the balancing adjustment event.[109]

181. Dependent upon the terms of the agreement, the termination value of the interest in the mining tenement transferred by the farmor to the farmee may be comprised of amounts received;[110]or the amount of a right granted to receive an amount;[111] in addition to the non-cash exploration benefits that flow to the farmor from the right to require the farmee to carry out the exploration work.[112]

182. CGT event D2[113] happened to the farmor upon the farmor granting the right to the farmee to acquire an interest in the mining tenement (see paragraph 158 of this draft Ruling). However, if there is a transfer of the interest in the mining tenement by the farmor to the farmee (CGT event A1), the capital gain or capital loss made by the farmor under CGT event D2 is disregarded.[114] The capital proceeds for the grant of that right that would have been included in working out any capital gain or loss made under CGT event D2 are included in the capital proceeds for CGT event A1.[115]

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[108] See subsection 40-300(1) of the ITAA 1997.
[109] Paragraph 40-305(1)(a) of the ITAA 1997 does not apply.
[110] See item 1 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[111] See item 3 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[112] See items 4 and 6 of the table in paragraph 40-305(1)(b) of the ITAA 1997. The term *non-cash benefit* is defined in subsection 995-1(1) of the ITAA 1997.
[113] Section 104-40 of the ITAA 1997.
[114] Subsection 104-40(5) of the ITAA 1997.
[115] Section 116-65 of the ITAA 1997.

183. CGT event A1 happens[116] to the farmor for the interest in the mining tenement that is transferred by the farmor to the farmee.[117] However, subsection 118-24(1) of the ITAA 1997 applies to disregard any capital gain or loss made on the transfer of the interest in the mining tenement if the decline in value of the interest in the mining tenement is, (or would be, if it was used), worked out under the UCA provisions. This is subject to the exclusions set out in subsection 118-24(2) of the ITAA 1997, which are not considered relevant to these circumstances. The capital proceeds under CGT event A1 (including those under CGT event D2) are included in the termination value of the interest in the mining tenement as these are amounts that the farmor is taken to have received under a balancing adjustment event.[118]

Exploration or prospecting expenditure deductions

184. Broadly speaking, expenditure incurred by an entity on exploration or prospecting is deductible under subsection 40-730(1) of the ITAA 1997 if the entity carried on mining operations, or proposed to carry on such operations, or carries on a business of, or a business that included, exploration or prospecting for minerals obtainable by mining operations.

185. The interest in the mining tenement that the farmor transfers to the farmee is in return for exploration or prospecting and to that extent the transfer of the interest secures exploration benefits for the farmor. For the reasons explained in Miscellaneous Taxation Ruling MT 2011/D1 (paragraphs 87 to 94), the farmor has incurred 'expenditure' for the purposes of subsection 40-730(1) of the ITAA 1997.

186. However, the expenditure incurred by an entity on exploration or prospecting is only deductible under subsection 40-730(1) of the ITAA 1997 subject to subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying.

187. If subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply, the deduction is allowed in the income year in which the expenditure is incurred. That is, the income year in which the farmee exercises the right to acquire the interest in the mining tenement.

188. Subsection 40-730(2) of the ITAA 1997 applies if the expenditure is on the following activities:

- development drilling for petroleum; or
- operations in the course of working a mining property, quarrying property or petroleum field.

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[116] See subsection 104-10(3) of the ITAA 1997 as to when the event happens.
[117] Section 104-10 of the ITAA 1997.
[118] Paragraph 40-305(1)(b) of the ITAA 1997.

189. Whether the interest in the mining tenement that the farmor transfers to the farmee is expended on an activity listed under subsection 40-730(2) of the ITAA 1997 necessarily depends on the particular facts and circumstances.

190. Activities for the purposes of subsection 40-730(2) of the ITAA 1997 include actual extraction activities and developmental work such as preparing a site for mining operations and providing water, light and power for use on the site for future mining operations as specified in section 40-860 of the ITAA 1997. As such, subsection 40-730(2) of the ITAA 1997 will apply to deny a deduction to a taxpayer in circumstances where the expenditure is for one of those developmental or mining operations activities rather than exploration or prospecting activities.

191. If the interest in the mining tenement that the farmor transfers to the farmee is not in return for an activity that falls within the definition of exploration or prospecting, but is, instead, in return for an activity, expenditure on which could give rise to the incurrence of capital expenditure by the farmee that is 'mining capital expenditure', under section 40-860 of the ITAA 1997 then subsection 40-730(2) of the ITAA 1997 will operate to deny the farmor's deduction under subsection 40-730(1) of the ITAA 1997.

192. For example, it may be the case that a 'bankable feasibility study' is specified as a component of the farmee's earn-in requirements under a deferred transfer farm-out arrangement.

193. If this feasibility study:

- is to evaluate the economic feasibility of mining minerals once they have been discovered;
- is undertaken to inform the parties' decision on whether or not to commit to a project to exploit a discovery;
- has a real and material connection to that decision; and
- is undertaken before such a decision is made,

then subsection 40-730(2) of the ITAA 1997 will not apply.

194. As such, to the extent that the farmor's transfer of the interest in the mining tenement secures the exploration benefits (that is, the bankable feasibility study), the farmor would be entitled to a deduction under subsection 40-730(1) of the ITAA 1997. The deduction is allowed in the income year in which the expenditure is incurred.

195. However, if the farmee has incurred expenditure on an activity that does not fall within the definition of 'exploration or prospecting' under subsection 40-730(4) of the ITAA 1997, the farmor is not entitled to a deduction under subsection 40-730(1) of the ITAA 1997.

196. Subsection 40-730(3) of the ITAA 1997 applies if the expenditure forms part of the cost of a depreciating asset.

The application of the UCA provisions to the farmee

197. There are no UCA consequences for the farmee upon the grant by the farmor of the right to acquire the interest in the mining tenement and the grant of the exclusive use and access rights to the mining tenement.

When the farmee starts to hold its interest

198. The farmee becomes the economic owner of the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the farmee exercises the right to acquire the interest and is able to exercise rights in relation to the interest in the mining tenement and there is a reasonable expectation that legal ownership will transfer to the farmee.

199. Whether this is the case will necessarily depend on the particular facts and circumstances. Relevant considerations include:

- whether the farmee exercises, or has a right to exercise immediately, the subject matter of the interest in the mining tenement. That is, whether the farmee:
  - has a right to explore the area covered by the mining tenement; or
  - becomes a joint venture participant whereby the joint venture operator acts on behalf of the farmee and the other participants in exploring the tenement; or
  - becomes the joint venture operator thus acting on its own behalf as well as on behalf of other participants.
- whether there are circumstances which would indicate that, contrary to the agreement, the farmee does not have a reasonable expectation of becoming the legal owner of the interest. However, the fact that completion of the agreement is conditional, for example, upon Foreign Investment Review Board or Ministerial approval, does not prevent the farmee from starting to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the farmee exercises the right to acquire the interest. It would normally be expected that the farm-out agreement is entered into on the basis of a reasonable expectation that the farmee will become the legal owner of the interest in the mining tenement.

200. The farmee becomes the legal owner of the interest in the mining tenement under item 10 of the table in section 40-40 of the ITAA 1997 once Ministerial (or other similar types of) approval is given to the transfer of the interest in the mining tenement. The change from item 5 to item 10 of the table in section 40-40 of the ITAA 1997 under which the farmee holds the interest in the mining tenement does not cause a further balancing adjustment event to occur.

First element of cost – interest in the mining tenement

201. The first element of cost of the interest the farmee starts to hold in the mining tenement is the same amount as the termination value of that interest to the farmor.[119]

202. If the farmee first uses the interest in the mining tenement for exploration or prospecting, the farmee is entitled to an immediate deduction for the cost of the interest under section 40-25 of the ITAA 1997 by applying subsection 40-80(1) of the ITAA 1997. The deduction is allowed in the income year in which the start time for the interest in the mining tenement occurs.[120] That is, the income year in which the interest in the mining tenement is first used for exploration or prospecting.

203. The question of whether the farmee's first use of the interest in the mining tenement is for exploration or prospecting, after the farmee begins to hold it, necessarily depends on the particular facts and circumstances.

204. A mining tenement permits a holder to explore for mineral deposits in a particular defined area. The threshold requirement to be satisfied for the decline in value of the mining tenement to be its cost under subsection 40-80(1) of the ITAA 1997 is that the farmee's first use of that mining tenement has to be for exploration or prospecting for minerals obtainable by mining operations.

205. For the use of the mining tenement to be for exploration or prospecting as defined in subsection 40-730(4) of the ITAA 1997 would require, at a minimum, that the farmee uses the mining tenement to explore for mineral deposits.

206. 'Exploration or prospecting' is defined in subsection 40-730(4) of the ITAA 1997 to include, among other things, feasibility studies to evaluate the economic feasibility of mining minerals or quarry materials once they have been discovered.[121]

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[119] See items 1 and 4 of the table in section 40-185 of the ITAA 1997.
[120] Section 40-60 of the ITAA 1997.
[121] Paragraph 40-730(4)(c) of the ITAA 1997.

207. A farmee may be required to undertake a feasibility study to evaluate the economic feasibility of mining the minerals that have been discovered within the area subject to the mining tenement as part of its exploration commitments under the deferred transfer farm-out agreement. Some kinds of feasibility studies may satisfy the definition of exploration or prospecting in subsection 40-730(4) of the ITAA 1997, but are not use of a mining tenement for the purposes of paragraph 40-80(1)(a) of the ITAA 1997 because they do not constitute or involve exploring for mineral deposits.

208. To put it another way, the inclusion of 'feasibility studies to evaluate the economic feasibility of mining minerals or quarry materials once they have been discovered' in the definition of exploration or prospecting in paragraph 40-730(4)(c) of the ITAA 1997 does not mean that conducting those activities automatically constitutes a use of a mining tenement which a farmee holds.

209. If the farmee does not first use a particular interest in the mining tenement for exploration or prospecting after the farmee begins to hold it, then the farmee is entitled to an annual decline in value deduction for the interest in the mining tenement under section 40-25 of the ITAA 1997.

Exploration or prospecting expenditure deductions

210. There are deductions available to the farmee in respect of expenditure incurred by the farmee in meeting its exploration commitments.

211. The farmee is entitled to a deduction under subsection 40-730(1) of the ITAA 1997 for expenditure the farmee incurs on exploration or prospecting of the mining tenement subject to the requirements of that provision being met and subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying. The deduction is allowed in the income year in which the expenditure is incurred. The discussion in paragraphs 186 to 196 of this draft Ruling as to whether subsection 40-730(2) or 40-730(3) of the ITAA 1997 applies to the farmor also applies to the farmee.

Deduction for expenditure on mining information

212. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee and the information obtained is mining, quarrying or prospecting information associated with searching for and evaluating areas containing minerals or quarry materials,[122] then the farmee is entitled to a deduction for the expenditure. The farmee is entitled to that deduction under subsection 40-730(1) of the ITAA 1997 if the requirements of that provision are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply. The deduction is allowed in the income year in which the expenditure is incurred.

The application of the ordinary income and deduction provisions

Sharing of mining information for identified consideration

Consequences for Farmor

213. If the parties have identified any consideration provided by the farmee as being for mining information shared[123] by the farmor with the farmee on entering into the arrangement, the consideration is assessable income of the farmor under section 6-5 or section 15-40 of the ITAA 1997. It is assessable income of the farmor in the income year in which it is derived (section 6-5 of the ITAA 1997) or received (section 15-40 of the ITAA 1997).

214. Consideration received for dealing with, or disclosing, mining information is assessable as ordinary income under section 6-5 of the ITAA 1997 if the information:

- is obtained for the purpose of profit making; or
- is dealt with or disclosed under an agreement for the provision of a service that involves sharing the information with another person and has no adverse effect on the profit-yielding structure of the business.

215. Section 15-40 of the ITAA 1997 provides that a taxpayer's assessable income includes any amount[124] received for providing mining information to another entity if:

- the taxpayer continues to hold the information for UCA purposes;[125] and
- the amount is not assessable as ordinary income under section 6-5 of the ITAA 1997.

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[122] See paragraph 40-730(4)(d) of the ITAA 1997.
[123] That is, the farmor continues to hold that mining information.
[124] An amount can include the value of a non-cash benefit (see sections 21 and 21A of the ITAA 1936).
[125] See section 40-40 of the ITAA 1997.

Consequences for farmee

216. The farmee's sharing of mining information from its exploration work with the farmor will not give rise to income tax consequences if it is merely part of the exploration benefits.

Grant of exclusive use and access rights

Consequences for farmor

217. The reward to the farmor for the grant of exclusive use and access rights is treated as being on revenue account.

218. The payments made by the farmee to, or on behalf of, the farmor for the grant of the exclusive use and access rights are assessable income for the farmor under section 6-5 of the ITAA 1997 in the income year in which the payments are derived.

219. The obligations the farmor has to third parties, such as for fees, rates and other charges for the maintenance of the mining tenement that are met by the farmee although incurred by the farmor, are deductible to the farmor under section 8-1 of the ITAA 1997 if the requirements of that section are satisfied. The deduction is allowed in the income year in which the expenses are incurred.

Consequences for the farmee

220. The farmee can deduct expenditure on the exclusive use and access rights under section 8-1 of the ITAA 1997 if the requirements of section 8-1 of the ITAA 1997 are satisfied. The deduction is allowed in the income year in which the expenditure is incurred.

Farmee's reward for providing exploration benefits

221. Reward for the provision of a non-cash benefit can be assessable as ordinary income under section 6-5 of the ITAA 1997. That is so even if the provision of the non-cash benefit is an isolated transaction rather than regularly provided as part of a business or profession of providing such benefits.[126]

222. To the extent consideration derived by the farmee (that is, the interest in the mining tenement from the farmor) is reward for the provision by the farmee of exploration benefits, it is assessable income of the farmee under section 6-5 of the ITAA 1997. That is, the provision of the exploration benefits are treated in the nature of a service by the farmee on revenue account.

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[126] See *Brent v. Commissioner of Taxation* (1971) 125 CLR 418; R.W Parsons, *Income Taxation in Australia,* Law Book Company, 1985, paragraphs 2.374 and 2.375.

223. It is assessable income in the income year in which the farmee exercises the right to acquire the interest in the mining tenement.

Farmee's exploration related expenditure

224. A farmee's expenditure that relates to its exploration work but which is not incurred on exploration or prospecting for the purposes of subsection 40-730(1) of the ITAA 1997 is deductible under section 8-1 of the ITAA 1997 if it is of a revenue character and satisfies the other requirements of section 8-1 of the ITAA 1997. For example, salary or wages of employees involved in general administration work for the farmee.

225. The deduction is allowed in the income year in which the expenditure is incurred.

Exploration benefits provided but no transfer of any interest in the mining tenement

Consequences for the farmor

226. If the relevant payment and exploration conditions are not met by the farmee, or the farmee does not exercise the right to acquire an interest in the mining tenement, there is no transfer of any interest in the mining tenement by the farmor to the farmee.

227. However, even though there is no transfer of an interest in the mining tenement, the farmor has still received exploration benefits from the farmee to the extent that the farmee has undertaken some of the exploration work. This exploration benefit is a non-cash business benefit to the farmor.[127] It is a non-cash business benefit that is not convertible to cash and, therefore, it is a benefit to which subsection 21A(1) of the ITAA 1936 applies to treat the benefit as if it were convertible to cash with its value being determined under subsection 21A(2) of the ITAA 1936.

228. However, subsection 21A(3) of the ITAA 1936 can also apply in respect of each income year in which exploration benefits are received by the farmor. The effect of subsection 21A(3) of the ITAA 1936 is to reduce the value of the benefit to the extent that the farmor would have been entitled to a deduction had the farmor incurred and paid unreimbursed expenditure in respect of the provision of the benefit.

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[127] Non-cash business benefit is defined in subsection 21A(5) of the ITAA 1936.

229. Thus, on the basis that the farmor would have been entitled to a deduction for such expenditure under subsection 40-730(1) of the ITAA 1997, no amount is returned as assessable income by the farmor in respect of that non-cash business benefit in each relevant income year that such exploration benefits are received. If the availability of a deduction does not hold true in the farmor's particular circumstances, this conclusion will also not hold true.

Consequences for the farmee

230. For the farmee there is no reward for the farmee's provision of exploration benefits as there is no transfer of the interest in the mining tenement. Therefore, there is no amount assessable to the farmee in return for its provision of the exploration benefits.

231. As the interest in the mining tenement has not been transferred, the UCA provisions are of no effect to give rise to a deduction for the farmee in relation to having acquired a depreciating asset. However, as mentioned at paragraph 211 of this draft Ruling, the farmee is entitled to a deduction under subsection 40-730(1) of the ITAA 1997 for actual exploration expenditure on the basis that it is carrying out exploration work (assuming that subsections 40-730(2) and 40-730(3) of the ITAA 1997 have no application in relation to that exploration work). The farmee may also be entitled to a deduction under section 8-1 of the ITAA 1997 if the expenditure is not deductible under subsection 40-730(1) of the ITAA 1997 (see further at paragraphs 224 and 225 of this draft Ruling).

Part C – Application of the GST law

Supply and consideration

232. Under the terms of a deferred transfer farm-out arrangement, the farmor grants the farmee a right (option) to acquire an interest in the mining tenement and also rights to exclusive use and access of the mining tenement.[128]

233. At a later point in time, the farmor may transfer that interest in the mining tenement to the farmee if the earn-in requirements are met and the farmee exercises the right to acquire the interest in the mining tenement.

[128] Normally, if a supplier enters into an agreement with an acquirer to supply a thing, the acquirer's right to the thing is not itself treated as a separate supply (see GSTR 2001/8). However, in this case, the farmee's rights under the farm-out arrangement to acquire the interest in the mining tenement are contingent. In that context, the rights of the farmee to exclusive use and access to the mining tenement to carry out exploration and to acquire the interest upon the earn-in requirements being met must, in accordance with section 9-10 of the GST Act, be treated as a supply separate from any supply of the interest which may (or may not) subsequently occur.

234. The consideration for the supplies of the various rights and the later supply of the interest in the mining tenement (if it occurs), is any payment or any act or forbearance in connection with, in response to or for the inducement of the supply.[129] Thus, consideration for GST purposes is of wide import[130] and the consideration from the farmee to the farmor for the various supplies includes any cash payments made to, or on behalf of, the farmor and exploration benefits that flow to the farmor from the farmee's exploration commitments under the farm-out agreement.

235. The GST consequences in relation to the various supplies are explained in paragraphs 236 to 264 of this draft Ruling.

Grant of the right to acquire an interest in the mining tenement and the exclusive use and access rights

236. The farmor makes a supply of the right to acquire the interest in the mining tenement, and a supply of exclusive use and access rights, to the farmee. These supplies are taxable supplies if the requirements of section 9-5 of the GST Act are met. The GST payable is attributable under the basic attribution rules in Division 29 of the GST Act.[131] The consideration for the supplies is explained in paragraphs 119 and 122 of this draft Ruling.

237. The farmee makes acquisitions of the right to acquire the interest in the mining tenement and exclusive use and access rights. If the acquisition is a creditable acquisition for the farmee, the input tax credit to the extent each acquisition is for a creditable purpose, is attributable under the basic attribution rules in Division 29 of the GST Act.

238. If the farmor or the farmee accounts for GST on a non-cash basis and consideration is received or provided before the total consideration for the supply or acquisition is known the following legislative instrument is relevant - *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000.*[132] These particular attribution rules override the basic attribution rules and the special rules in Chapter 4 of the GST Act but only to the extent of any inconsistency and only to the extent provided for in the legislative instrument.

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[129] Section 9-15 of the GST Act.
[130] See for example, paragraph 79 of Goods and Services Tax Ruling GSTR 2001/4 Goods and services tax: GST consequences of court orders and out-of-court settlements.
[131] The basic attribution rules are explained in Goods and Services Tax Ruling GSTR 2000/29 Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25.
[132] This legislative instrument is available at www.ato.gov.au.

Mining information

239. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee on entering into the arrangement, the sharing of that information is treated as a supply by the farmor separate from the supply of the interest in the mining tenement. The consideration for the interest in the mining tenement would not include any consideration identified for the mining information.

240. GST payable by the farmor, and any input tax credits able to be claimed by the farmee, are attributable under the basic attribution rules.

Supply of the interest in the mining tenement by the farmor in return for the supply of exploration benefits by the farmee and monetary payments (if any)

Consequences for the farmor

241. The farmor's supply of the interest in the mining tenement is a taxable supply if the requirements of section 9-5 of the GST Act are satisfied.

242. The exploration benefits that the farmee provides to the farmor is additional consideration provided in connection with the exercise of the right (option) to acquire the interest in the mining tenement.[133] If upon exercise of the right to acquire the interest, or upon transfer of the interest, there are additional monetary payments made by the farmee, those payments would also be additional consideration provided for the supply of the interest in the mining tenement. It follows from this that the exploration benefits are not consideration in connection with the acquisition of the right to acquire an interest in the mining tenement, or the exclusive use and access rights.

243. The farmor is entitled to an input tax credit for the acquisition of exploration benefits if it is a creditable acquisition.

Attribution of GST payable

244. The exploration benefits flow from the exploration work that must be completed by the farmee if the farmee is to exercise the right to acquire the interest in the mining tenement. However, most if not all of the exploration work is at the farmee's discretion and so the exploration benefits that flow to the farmor from that work are received by the farmor during the earn-in period and before it is known if there will be a supply of the interest in the mining tenement.

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[133] Subparagraph 9-15(3)(a)(i) of the GST Act. The consideration provided by the farmee for the grant of the right (option) to acquire the interest in the mining tenement is not included as it has already been attributed in relation to the taxable supply of that right.

245. For this reason, a draft legislative instrument[134] proposes attribution rules to ensure that the attribution of GST payable on the taxable supply of the interest in the mining tenement occurs as follows:

(i) *if the farmor accounts for GST on a non-cash basis* - GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire the interest. This applies to both monetary and non-monetary consideration for the supply of the interest in the mining tenement; and

(ii) *if the farmor accounts for GST on a cash basis* - GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the interest is transferred to the extent that the consideration received for that supply is exploration benefits.

246. A farmor that accounts for GST on a cash basis attributes the GST payable on any monetary consideration received for the taxable supply of the interest in the mining tenement to a tax period, to the extent that the monetary consideration is received in that tax period.[135] In this case the attribution rules apply appropriately and it is therefore not covered by the legislative instrument.

Attribution of input tax credits

247. The basic attribution rules under Division 29 of the GST Act apply to the attribution of input tax credits.

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[134] A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2011. This draft legislative instrument along with the draft explanatory statement is available for comment.

[135] Subsection 29-5(2) of the GST Act.

248. If a farmor accounts for GST on a non-cash basis the input tax credit is attributable to the tax period in which any consideration is provided by the farmor, or the farmee issues an invoice to the farmor, if this occurs first.[136] The interest in the mining tenement is provided to the farmee when the interest in the mining tenement is transferred from the farmor to the farmee.[137] The agreement entered into for the deferred transfer farm-out arrangement is also not an invoice for the transfer of the interest in the mining tenement or the exploration benefits.[138] In any case, to claim an input tax credit the farmor must also hold a tax invoice issued by the farmee.[139]

249. The earliest tax period to which the input tax credit could be attributed for a non-cash basis farmor is the tax period in which the farmee, having satisfied the earn-in requirements, exercises the right to acquire the interest in the mining tenement and issues a tax invoice[140] to the farmor.

250. The farmee could not issue a tax invoice earlier than this as prior to this point in time an obligation for the farmor to supply the interest in the mining tenement has not crystallised and thus there is no basis upon which a farmor would issue a tax invoice for a supply.

251. If a farmor accounts for GST on a cash basis, the input tax credit is attributable to a tax period to the extent that consideration is provided to the farmee.[141] On this basis the input tax credit is attributable to the tax period in which the interest in the mining tenement is transferred from the farmor to the farmee, assuming the farmee has provided the farmor with a tax invoice at this time.

Consequences for the farmee

252. The farmee's supply of exploration benefits is a taxable supply if the requirements of section 9-5 of the GST Act are met. The consideration for the farmee's supply is the interest in the mining tenement provided by the farmor.

253. The farmee is also entitled to an input tax credit for the acquisition of the interest in the mining tenement if it is a creditable acquisition.

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[136] Subsection 29-10(1) of the GST Act.
[137] This is consistent with the view in paragraph 195 of Goods and Services Tax Ruling GSTR 2001/6 Goods and services tax: non-monetary consideration.
[138] See paragraphs 28 to 31 of Goods and Services Tax Ruling GSTR 2000/34 Goods and services tax: what is an invoice for the purposes of the A New Tax System (Goods and Services Tax) Act 1999 ('GST Act')? The Ruling explains that a document is an invoice if it notifies a presently existing obligation and that it is not enough that an amount may become payable in the future.
[139] Subsection 29-10(3) of the GST Act.
[140] Subsection 29-10(3) of the GST Act.
[141] Subsection 29-10(2) of the GST Act.

Attribution of GST payable

254. The basic attribution rules under Division 29 of the GST Act apply to the attribution of GST payable.

255. If a farmee accounts for GST on a non-cash basis the GST payable by the farmee is attributable to the tax period in which any of the consideration is received by the farmee, or the farmee issues an invoice to the farmor if this occurs first.

256. The interest in the mining tenement is received by the farmee when the interest in the mining tenement is transferred from the farmor to the farmee.[142] The GST payable is therefore attributable to the tax period in which this transfer occurs, unless the farmee issues an invoice to the farmor in an earlier tax period. As explained at paragraph 250 of this draft Ruling, the earliest tax period in which a farmee could issue an invoice is the tax period in which the farmee, having completed the earn-in requirements, exercises the right to acquire the interest in the mining tenement.

257. If a farmee accounts for GST on a cash basis the GST payable is attributable to a tax period to the extent that consideration is received in that tax period. On this basis the GST payable is attributable to the tax period in which the interest in the mining tenement is transferred to the farmee.

Attribution of input tax credits

258. A draft legislative instrument[143] proposes attribution rules to ensure that the attribution of an input tax credit for a creditable acquisition of the interest in the mining tenement occurs as follows:

(i) *if the farmee accounts for GST on a non-cash basis* - the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest; and

(ii) *if the farmee accounts for GST on a cash basis* - the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest to the extent of any consideration provided in that tax period or an earlier tax period for that acquisition.

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[142] This is consistent with the view in paragraph 195 of Goods and Services Tax Ruling *GSTR 2001/6 Goods and services tax: non-monetary consideration*.

[143] A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2011. This draft legislative instrument along with the draft explanatory statement is available for comment.

259. If a cash basis farmee provides further consideration upon the transfer of the interest in the mining tenement, the input tax credit with respect to that further consideration, is attributable in the tax period in which the consideration is provided according to the basic attribution rules.

260. The tax period in which the farmee exercises the right to acquire that interest is the earliest tax period in which the farmor could issue the farmee with a tax invoice.

261. The legislative instrument ensures that the four year time limit[144] 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 making an acquisition, and thus a creditable acquisition, and the farmor can not issue a tax invoice due to a lack of certainty as to any obligation to make a supply.

Supply of exploration benefits but no supply of the interest in the mining tenement

262. If there is no supply of the interest in the mining tenement by the farmor to the farmee:

- the farmor does not make a taxable supply of the interest in the mining tenement and, as consideration is not provided by the farmor, the farmor does not make a creditable acquisition of any exploration benefits; and
- the farmee does not make a taxable supply of the exploration benefits as there is no consideration provided by the farmor, and the farmee does not make an acquisition of the interest in the mining tenement.

263. It is assumed that the farmee has not made a monetary payment to the farmor for the supply of the interest in the mining tenement as any monetary payment for the supply of the interest would be made upon exercise of the right to acquire the interest or at the time of the transfer of the interest.

264. An adjustment event may arise for a farmor or a farmee if they have attributed GST payable or input tax credits to a tax period, for example, the tax period in which the right to acquire the interest in the mining tenement is exercised by the farmee but ultimately there is no transfer of that interest by the farmor. For example, if the interest in the mining tenement is ultimately not transferred because Ministerial approval is not given to the transfer. This effectively results in the cancellation of the farmor's supply, and the farmee's acquisition, of the interest in the mining tenement under the terms of the contract, albeit for reasons outside of either party's control.[145]

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[144] Division 93 of the GST Act.

[145] For further explanation on adjustment events see Goods and Services Tax Ruling GSTR 2000/19 Goods and services tax: making adjustments under Division 19 for adjustment events.

GST going concern

265. Paragraph 195 of GSTR 2002/5[146] explains that it is possible for a joint venturer entity to make a GST-free 'supply of a going concern', including when part of the enterprise conducted by the joint venturer is supplied, providing all of the requirements of section 38-325 of the GST Act, as explained in GSTR 2002/5, are satisfied.

266. If a supply by a joint venturer farmor (which includes the supply of the interest in the mining tenement) is the supply of a going concern that is a GST-free supply under section 38-325 of the GST Act, the farmee will not have any input tax credits to claim and the farmor will have no GST payable in respect of that supply. However, GST is payable by the farmee in respect of its supply of the exploration benefits to the farmor and the farmor may be entitled to input tax credits.

[146] Goods and Services Tax Ruling GSTR 2002/5: when is a 'supply of a going concern' GST-free?

Appendix 2 – Example

Example 3 – Monetary payments and non-cash exploration benefits – the interest in the mining tenement is transferred to the farmee

267. This example assumes the following facts:

- Farmor Co holds a 100% interest in a mining tenement;
- The mining tenement is at the exploration stage and therefore the mining tenement has no adjustable value for tax purposes (that is, a deduction has previously been claimed in full for the cost of the mining tenement);
- Farmor Co and Farmee Co enter into a deferred transfer farm-out arrangement. If Farmee Co earns a 60% interest, it will leave Farmor Co with a 40% interest. Farmee Co and Farmor Co are dealing with each other at arm's length;
- Farmee Co is required to pay Farmor Co $70,000 (GST-exclusive) for the grant of exclusive use and access rights and $1,000 (GST-exclusive) for the grant of the right to acquire an interest in the mining tenement upon entering into the agreement;
- Farmee Co is also required to meet all fees, rent, rates and other charges while the agreement is on foot in return for the grant of exclusive use and access rights (assume that this is $100,000 (GST-exclusive) for the purposes of showing Farmor Co's and Farmee Co's income tax consequences);
- Farmee Co is required to carry out initial exploration work to the GST-exclusive value of $150,000 (mandatory exploration);
- Farmee Co must carry out further exploration work to the GST-exclusive value of $1,000,000 (optional exploration) over the earn-in period of 3 years if it is to earn an interest in the mining tenement. That is, total exploration work to the GST-exclusive value of $1,150,000;
- Farmor Co shares mining information with Farmee Co, but separate consideration is not identified for that element of the arrangement;
- Farmee Co is required to share any mining information with Farmor Co;

- Farmee Co may withdraw from the agreement by giving notice to Farmor Co at any time during the earn-in period once the mandatory exploration work is completed provided the mining tenement is in good order at the time of the notice. If Farmee Co gives such notice to withdraw, it will not earn any interest in the mining tenement; and
- The market valuation of the 60% interest in the mining tenement is $500,000 (GST-exclusive). This market valuation is based on all the facts and surrounding circumstances including the terms of the agreement and what is known about the mining tenement at the time of entry into the agreement. It is reasonable to assume, therefore, that the market value of the exploration benefit provided to the farmor is $499,000.[147]

268. The amounts and values in this example are used purely to illustrate the calculations required under this draft Ruling and should not be taken to imply anything about how to work out the value of things in particular cases.

Income tax – Farmor Co

269. The net income tax consequences for Farmor Co are summarised as follows.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997 unless otherwise stated**	**Timing**
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmor Co grants Farmee Co the right to acquire an interest in the mining tenement for a payment of $1,000.	CGT event D2 – grant of the right Capital gain equals $1,000.[148] (See paragraphs 158 and 159 of this draft Ruling.)	When the farm-out agreement is entered into.

[147] Worked out as $500,000 market value of the 60% interest in the mining tenement reduced by the $1,000 cash payment that relates to the acquisition of that tenement.

[148] A capital gain or loss is determined as capital proceeds ($1,000) less costs in granting the right. This assumes the costs in granting the right are nil. Any capital gain or loss under CGT event D2 is subsequently disregarded to the extent that the right is exercised and the interest in the mining tenement is transferred to Farmee Co.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997 unless otherwise stated**	**Timing**
2 – Farmor Co grants Farmee Co exclusive use and access rights for a payment of $70,000 and also payments of up to $100,000.	$70,000 Up to $100,000 The receipt of the payments is treated on revenue account and assessable under section 6-5. (See paragraphs 217 and 218 of this draft Ruling.)	$70,000 - when the farm-out agreement is entered into. Up to $100,000 - as and when the income is derived.
3 – Expenditure is incurred by Farmor Co as holder of the mining tenement for fees, rents, rates and other outgoings relating to the maintenance of the mining tenement (effectively met by Farmee Co as part of the farm-out arrangement).	Up to ($100,000) This assumes amounts incurred meet the requirements for deductibility under section 8-1. (See paragraph 219 of this draft Ruling.)	As and when the expenditure is incurred.
Summary	*Net capital gain = $1,000* *Net revenue income = $70,000*	

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997 unless otherwise stated**	**Timing**
Transfer of the interest in the mining tenement		
4 – Farmee Co completes its earn-in obligations and exercises the right to acquire an interest in the mining tenement. Farmor Co transfers the interest in the mining tenement. Farmor Co receives a non-cash exploration benefit of $499,000 and $1,000 cash payment in relation to the grant of the right. Any capital gain or loss made on the grant of the right (CGT event D2) is subsequently disregarded for CGT purposes and included for UCA purposes. Any capital gain or loss under CGT event A1 is also disregarded.	***CGT*** $1,000 reversal of an amount in an earlier year. (See paragraph 166 of this draft Ruling.) ***UCA outcome*** $1,000 item 1 of the table in paragraph 40-305(1)(b) $499,000 item 4 of the table in paragraph 40-305(1)(b) (See paragraphs 167 to 169 and 175 to 183 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
5 - Farmor Co expends the 60% interest in the mining tenement partly in return for the exploration benefits.	($499,000) Subsection 40-730(1) providing that the expenditure incurred satisfies the tests of deductibility under section 40-730. (See paragraphs 184 to 196 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
Summary	*($1,000) amendment in relation to CGT event D2 in an earlier year* *$1,000 – current year*	

Event	Assessable/ (Deductible) **all legislative references are to the ITAA 1997 unless otherwise stated**	Timing
Exploration benefits provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $100,000 in year 1 and $50,000 in year 2[149] *(approximately) over the 1½ years that the agreement was on foot.*		
6 – Farmee Co notifies Farmor Co that it is withdrawing from the agreement.	Non-cash business benefit $100,000 in year 1. Non-cash business benefit $50,000 in year 2. Otherwise deductible amount is $100,000 in year 1 and $50,000 in year 2. Therefore, no amount to be included in Farmor Co's assessable income. Section 21 and subsections 21A(1), 21A(2) and 21A(3) of the ITAA 1936. (See paragraphs 226 to 229 of this draft Ruling.) *Note: this outcome is the alternative outcome to outcomes 4 and 5.*	

[149] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.

Income tax – Farmee Co

270. The net income tax consequences for Farmee Co are summarised as follows.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997**	**Timing**
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmee Co acquires a CGT asset being the right to acquire the interest.	Cost base of $1,000. (See paragraph 160 of this draft Ruling.) [Capital loss under CGT event C2 equal to $1,000 upon ending of the right if the $1,000 is not deductible.] (See paragraph 161 of this draft Ruling.)	When the farm-out agreement is entered into. [In the income year in which the right ends.]
2 – Farmee Co pays for the rights to exclusive use and access.	($70,000) + up to ($100,000) Section 8-1. (See paragraph 220 of this draft Ruling.) [Capital loss under CGT event C2 equal to $170,000 upon ending of the rights if the $170,000 is not deductible.] (See paragraph 165 of this draft Ruling.)	When the expenditure is incurred. [In the income year in which the rights end.]
Summary 1 and 2	*($170,000)* [Capital loss of $171,000 upon ending of both rights if $171,000 is not deductible.]	

Event	Assessable/ (Deductible) **all legislative references are to the ITAA 1997**	Timing
Transfer of the interest in the mining tenement		
3 – In return for Farmor Co transferring a 60% interest in the mining tenement to Farmee Co, Farmee Co provides non-cash exploration benefits to Farmor Co of $499,000. Also included is the $1,000 cash payment initially for the right to acquire the interest.	($1,000) item 1 of the table in paragraph 40-185(1)(b) ($499,000) item 4 of the table in paragraph 40-185(1)(b) $500,000 is the first element of cost and immediately deductible if the 60% interest is first used for exploration or prospecting: subsections 40-80(1) and 40-25(1) providing that the requirements under subsection 40-80(1) are satisfied. (See paragraphs 197 to 209 of this draft Ruling.)	If deductible applying subsection 40-80(1) - when Farmee Co's interest in the mining tenement is first used for exploration or prospecting. Otherwise decline in value under section 40-25.
4 - Farmee Co earns a 60% interest in the mining tenement as its reward for the exploration benefits.	$499,000 Section 6-5 . $499,000 of the interest earned by the farmee is attributable to its provision of exploration benefits. (See paragraphs 221 to 223 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
5 – Farmee Co incurs expenditure on exploration of $1,150,000.	($1,150,000) Section 8-1 or 40-730 providing the requirements of those sections have been satisfied. (See paragraphs 210 and 211 and 224 and 225 of this draft Ruling.)	As and when the expenditure is incurred.

Event	Assessable/ (Deductible) **all legislative references are to the ITAA 1997**	Timing
Overall summary	*($170,000)* *(summary of 1 & 2)* *($1,000)* *(summary of 3 & 4)* *($1,150,000)* *(summary of 5)*	
Exploration benefits provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $100,000 in year 1 and $50,000 in year 2[150] *(approximately) over the 1½ years that the agreement was on foot.*		
6 – Farmee Co incurs expenditure on exploration of $345,000	($345,000) Section 8-1 or 40-730. (See paragraphs 230 and 231 of this draft Ruling.)	As and when the expenditure is incurred.
Summary *Note: This outcome is the alternative outcome to outcomes 3, 4 and 5.*	*($345,000)*	*As and when incurred.*

GST outcomes for Farmor Co and Farmee Co

271. The combined net GST consequences for Farmor Co and Farmee Co is summarised as follows. It assumes that:

- Farmor Co and Farmee Co are each registered for GST and account for GST on a non-cash basis; and
- the supplies are taxable supplies and the acquisitions are creditable acquisitions for a fully creditable purpose.

Event	GST payable/input tax credits (ITCs)	Attribution (non-cash basis)
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmor Co makes a taxable supply of the right to acquire an interest in the mining tenement.	GST payable of $100 ($1,000 x 10% = $100; GST-inclusive price of $1,100) (See paragraphs 236 to 238 of this draft Ruling.)	Earlier of the issue of an invoice, or receipt of any consideration, by Farmor Co.

[150] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.

Event	**GST payable/input tax credits (ITCs)**	**Attribution** (non-cash basis)
2 – Farmor makes a taxable supply of the exclusive use and access rights.	GST payable of $7,000 + up to $10,000 ($70,000 x 10% = $7,000; GST-inclusive price of $77,000) ($100,000 x 10% = $10,000; GST-inclusive price of $110,000) (See paragraphs 236 to 238 of this draft Ruling.)	Earlier of the issue of an invoice, or receipt of any consideration, by Farmor Co; or according to the legislative determination where total consideration is not known (PAR 2000/1).
3 – Farmee Co makes a creditable acquisition of the right (option) to acquire an interest in the mining tenement.	ITCs claimable of $100 (See paragraphs 236 to 238 of this draft Ruling.)	Earlier of the issue of an invoice, or any consideration provided and Farmee Co holds a tax invoice.
4 – Farmee Co makes a creditable acquisition of exclusive use and access rights.	ITCs claimable of $7,000 + up to $10,000 (See paragraphs 236 to 238 of this draft Ruling.)	Earlier of the issue of an invoice, or any consideration provided; or according to the legislative determination where total consideration is not known (PAR 2000/1); and Farmee Co holds a tax invoice.
Transfer of the interest in the mining tenement		
5 – Farmor Co makes a taxable supply of the interest in the mining tenement (consideration is exploration benefits).	GST payable of $49,900 ($499,000 x 10% = $49,900; GST-inclusive price of $548,900) (See paragraphs 241 and 242 and 244 to 246 of this draft Ruling.)	In the tax period when Farmee Co exercises the right to acquire the interest in the mining tenement under the proposed legislative instrument.

Event	**GST payable/input tax credits (ITCs)**	**Attribution** (non-cash basis)
6 – Farmee Co makes a creditable acquisition of the interest in the mining tenement (consideration is exploration benefits).	ITCs claimable of $49,900 (See paragraphs 253 and 258 to 261 of this draft Ruling.)	In the tax period when Farmee Co exercises the right to acquire the interest and holds a tax invoice under the proposed legislative instrument.
7 – Farmee Co makes a taxable supply of exploration benefits (consideration is the interest in the mining tenement).	GST payable of $49,900 ($499,000 x 10% = $49,900; GST-inclusive price of $548,900) (See paragraphs 252 and 254 to 257 of this draft Ruling.)	In the tax period when an invoice is issued or any of the consideration is received[151], whichever is earlier.
8 – Farmor Co makes a creditable acquisition of exploration benefits (consideration is the interest in the mining tenement).	ITCs claimable of $49,900 (See paragraphs 243 and 247 to 251 of this draft Ruling.)	Earlier of the issue of an invoice, or any consideration provided[152] and Farmor Co holds a tax invoice.
Overall summary	*Farmor Co* Pays GST of $7,100 and up to $10,000 May also pay GST of $49,900 and claim an ITC of $49,900 *Farmee Co* Claims ITCs of $7,100 and up to $10,000. May also claim an ITC of $49,900 and pay GST of $49,900	

[151] Consideration is received by Farmee Co when the interest in the mining tenement is transferred from Farmor Co to Farmee Co.
[152] Consideration is provided by Farmor Co when the interest in the mining tenement is transferred from Farmor Co to Farmee Co.

Event	GST payable/input tax credits (ITCs)	Attribution (non-cash basis)
Exploration benefits provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $150,000[153] *(approximately) over the 1½ years that the agreement was on foot.*		
9 – Farmor Co does not transfer a 60% interest in the mining tenement to Farmee Co.	Farmor Co No further GST consequences as there is no supply of the interest in the mining tenement by Farmor Co. Farmee Co No further GST consequences as there is no acquisition of the interest in the mining tenement. (See paragraphs 262 to 264 of this draft Ruling.)	

Example 4 – Monetary payments and non-cash exploration benefits – the interest in the mining tenement is transferred to the farmee in two tranches

272. This example assumes the following facts:

- Farmor Co holds a 100% interest in a mining tenement.
- The tenement is at the exploration stage and therefore the tenement has no adjustable value for tax purposes (that is, a deduction has previously been claimed in full for the cost of the tenement);
- Farmor Co and Farmee Co enter into a deferred transfer farm-out arrangement. Farmee Co has the opportunity to earn a 30% interest and then a further 30% interest to potentially give it a total 60% interest, leaving Farmor Co with a 40% interest. Farmee Co and Farmor Co are dealing with each other at arm's length;
- Farmee Co is required to pay Farmor Co $70,000 (GST-exclusive) for the grant of exclusive use and access and $1,000 (GST-exclusive) for the grant of the right to acquire both 30% interests upon entering into the agreement;

[153] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.

- Farmee Co is also required to meet all fees, rent, rates and other charges while the agreement is on foot in return for the grant of exclusive use and access rights (assume that this is $100,000 (GST-exclusive) for the purposes of showing Farmor Co's and Farmee Co's income tax consequences);
- Farmee Co is required to carry out initial exploration work to the GST-exclusive value of $150,000 (mandatory exploration);
- Farmee Co must carry out further exploration work to the GST-exclusive value of $1,000,000 (optional exploration) over the earn-in period of 3 years if it is to earn its first tranche 30% interest in the mining tenement;
- Farmee Co must carry out further exploration work to the GST-exclusive value of $500,000 (optional exploration) over a further 2 year period and prepare a bankable feasibility study in relation to the project. On delivery of the bankable feasibility study, Farmee Co will be entitled to request a transfer of the second tranche 30% interest in the mining tenement, bringing its total interest to 60%;
- Exploration work under the arrangement therefore totals the GST-exclusive value of $1,650,000;
- Farmor Co shares mining information with Farmee Co, but separate consideration is not identified for that element of the arrangement;
- Farmee Co is required to share any mining information with Farmor Co;
- Farmee Co may withdraw from the agreement by giving notice to Farmor Co at any time during the earn-in period once the mandatory exploration work is completed provided the mining tenement is in good order at the time of the notice. If Farmee Co gives such notice to withdraw, it will not earn any interest in the mining tenement;
- The market value of the total 60% interest in the mining tenement is $500,000 at the time of execution of the farm-in agreement. It is reasonable to assume, therefore, that the market value of the exploration benefit provided to the farmor is $499,000;[154] and

[154] Worked out as $500,000 market value of the 60% interest in the mining tenement reduced by the $1,000 cash payment that relates to the acquisition of that tenement.

- The first and second tranches of the interest in the mining tenement were transferred from the farmor to the farmee.

Income tax – Farmor Co

273. The net income tax consequences for Farmor Co are summarised as follows.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997**	**Timing**
Upon entry into the agreement and before the right to acquire any interest in the mining tenement is exercised		
1 – Farmor Co grants Farmee Co the right to acquire up to a 60% interest for a payment of $1,000.	CGT event D2 – grant of the right. Capital gain equals $1,000.[155] (See paragraphs 158 and 159 of this draft Ruling.)	When the farm-out agreement is entered into.
2 – Farmor Co grants Farmee Co exclusive use and access rights for a payment of $70,000 and also payments of up to $100,000.	$70,000 Up to $100,000 The receipt of the payments is treated on revenue account and assessable under section 6-5. (See paragraphs 217 and 218 of this draft Ruling.)	$70,000 - when the farm-out agreement is entered into. Up to $100,000 - as and when the income is derived.
3 – Expenditure is incurred by Farmor Co as holder of the tenement for fees, rents, rates and other outgoings relating to the maintenance of the tenement (effectively met by Farmee Co as part of the farm-out arrangement).	Up to ($100,000) This assumes amounts incurred meet the requirements for deductibility under section 8-1. (See paragraph 219 of this draft Ruling.)	As and when the expenditure is incurred.
Summary	*Net capital gain = $1,000* *Net revenue income = $70,000*	

[155] A capital gain or loss is determined as capital proceeds ($1,000) less costs in granting the option. This assumes the costs in granting the option are nil. Any capital gain or loss under CGT event D2 is subsequently disregarded to the extent that the option is exercised and the interest in the mining tenement is transferred to Farmee Co.

Event	Assessable/ (Deductible) **all legislative references are to the ITAA 1997**	Timing
Transfer of the first tranche 30% interest in the mining tenement		
4 – Farmee Co completes the first tranche earn-in obligations and exercises the right to acquire the first tranche interest of 30%. Farmor Co transfers the relevant interest in the mining tenement. Farmor Co receives a non-cash exploration benefit of the proportionate share of the $499,000 from the farmee's exploration work and the proportionate share of the $1,000 cash payment in relation to the grant of the right. Any capital gain or loss made on the grant of the right (CGT event D2) is subsequently disregarded for CGT purposes and included for UCA purposes. Any capital gain or loss under CGT event A1 is also disregarded.	***CGT*** $500 reversal of an amount in an earlier year (See paragraph 166 of this draft Ruling.) ***UCA outcome*** $500 item 1 of the table in paragraph 40-305(1)(b) $249,500 item 4 of the table in paragraph 40-305(1)(b). (See paragraphs 167 to 169 and 175 to 183 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
5 - Farmor Co expends the first tranche 30% interest in the mining tenement partly in return for the proportionate share of the exploration benefits relating to that 30% interest.	($249,500) Subsection 40-730(1) providing that the expenditure incurred satisfies the tests of deductibility under section 40-730. (See paragraphs 184 to 196 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
Summary	*$500 – current year* *($500) amendment in relation to CGT event D2 in an earlier year.*	

Event	Assessable/ (Deductible) **all legislative references are to the ITAA 1997**	Timing
Transfer of the second tranche 30% interest in the mining tenement		
6 – Farmee Co completes the second tranche earn-in obligations and exercises the right to acquire the second tranche interest of 30%. Farmor Co transfers the relevant interest in the mining tenement. Farmor Co receives the remaining proportionate share of the non-cash exploration benefit and the $1,000 cash payment in relation to the grant of the right. The CGT consequences are as for 4.	***CGT*** $500 reversal of an amount in an earlier year (See paragraph 166 of this draft Ruling.) ***UCA outcome*** $500 item 1 of the table in paragraph 40-305(1)(b) $249,500 item 4 of the table in paragraph 40-305(1)(b). (See paragraphs 167 to 169 and 175 to 183 of this draft Ruling.)	When the farmee exercises the right to acquire the interest in the mining tenement for the second tranche.
7 - Farmor Co expends the second tranche 30% interest in the mining tenement partly in return for the proportionate share of the exploration benefits relating to that 30% interest.	($249,500) subsection 40-730(1) providing that the expenditure incurred satisfies the tests of deductibility under section 40-730. (See paragraphs 184 to 196 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement for the second tranche.
Summary	*$500 – current year* *($500) amendment in relation to CGT event D2 in an earlier year.*	

Income tax – Farmee Co

274. The net income tax consequences for Farmee Co are summarised as follows.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997**	**Timing**
Upon entry into the agreement and before the right to acquire any interest in the mining tenement is exercised		
1 – Farmee Co acquires a CGT asset being the right to acquire the interest.	Cost base of $1,000 (See paragraph 160 of this draft Ruling.) [Capital loss under CGT event C2 equal to $1,000 upon ending of the right if the $1,000 is not deductible.] (See paragraph 161 of this draft Ruling.)	When the farm-out agreement is entered into. [In the income year in which the right ends.]
2 – Farmee Co pays for the rights to exclusive use and access.	($70,000) + up to ($100,000) Section 8-1. (See paragraph 220 of this draft Ruling.) [Capital loss under CGT event C2 equal to $170,000 upon ending of the right if the $170,000 is not deductible.] (See paragraph 165 of this draft Ruling.)	When the expenditure is incurred. [In the income year in which the rights end.]
Summary 1 and 2	*($170,000)* [Capital loss of $171,000 upon ending of both rights if $171,000 is not deductible.]	

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997**	**Timing**
Transfer of the first tranche 30% interest in the mining tenement		
3 – In return for Farmor Co transferring the first tranche 30% interest in the mining tenement to Farmee Co, Farmee Co provides non-cash exploration benefits to Farmor Co equal to the proportionate amount of the $499,000 and the proportionate share of the $1,000 cash payment initially for the right to acquire the interest.	($500) item 1 of the table in paragraph 40-185(1)(b) ($249,500) item 4 of the table in paragraph 40-185(1)(b) $250,000 is the first element of cost and immediately deductible if the 30% interest is first used for exploration or prospecting: subsections 40-80(1) and 40-25(1) providing that the requirements under subsection 40-80(1) are satisfied. (See paragraphs 197 to 209 of this draft Ruling.)	If deductible applying subsection 40-80(1) - when Farmee Co's interest in the mining tenement is first used for exploration or prospecting. Otherwise, decline in value under section 40-25.
4 - Farmee Co earns a 30% interest in the mining tenement as its reward for the exploration benefits.	$249,500 Section 6-5 . $249,500 of the interest earned by the farmee is attributable to its provision of exploration benefits. (See paragraphs 221 to 223 of this draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.

Event	**Assessable/ (Deductible)** **all legislative references are to the ITAA 1997**	**Timing**
Transfer of the second tranche 30% interest in the mining tenement		
5 – In return for Farmor Co transferring the second tranche 30% interest in the mining tenement to Farmee Co, Farmee Co provides the remaining proportionate non-cash exploration benefits to Farmor Co and the $1,000 cash payment initially for the right to acquire the interest.	($500) item 1 of the table in paragraph 40-185(1)(b) ($249,500) item 4 of the table in paragraph 40-185(1)(b) $250,000 is the first element of cost and is immediately deductible if the 30% interest is first used for exploration or prospecting: subsections 40-80(1) and 40-25(1) providing that the requirements under subsection 40-80(1) are satisfied. (See paragraphs 197 to 209 of this draft Ruling.)	If deductible applying subsection 40-80(1) - when Farmee Co's interest in the mining tenement is first used for exploration or prospecting. Otherwise, decline in value under section 40-25.
6 - Farmee Co earns a second 30% interest in the mining tenement as its reward for the exploration benefits.	$249,500 Section 6-5. $249,500 of the interest earned by the farmee is attributable to its provision of exploration benefits. (See paragraphs 221 to 223 of the draft Ruling.)	When Farmee Co exercises the right to acquire the interest in the mining tenement.
7 – Farmee Co incurs expenditure on exploration of $1,150,000.	($1,150,000) Section 8-1 or 40-730 providing the requirements of those sections have been satisfied. (See paragraphs 210 and 211 and 224 and 225 of this draft Ruling.)	As and when the expenditure is incurred.
Overall summary	*($170,000)* *(summary 1 & 2)* *($1,000)* *(summary of 3, 4, 5 & 6)* *($1,150,000)* *(summary of 7)*	

GST outcomes for Farmor Co and Farmee Co

275. For GST purposes, each 30% tranche of the interest in the mining tenement is a separate supply. The same principles illustrated in Example 3 apply for the calculation of GST payable and input tax credits for both Farmor Co and Farmee Co.

Appendix 3 – Your comments

276. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

277. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the ATO website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**7 October 2011**
Contact officer:	**Mark Sheaves (income tax)**
Email address:	**mark.sheaves@ato.gov.au**
Telephone:	**(07) 3213 6063**
Contact officer:	**Grant Murphy (GST)**
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Address:	**Australian Taxation Office** **PO Box 900** **Brisbane QLD 4000**

Appendix 4 - Detailed contents list

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- balancing adjustment event
- disposal of mining & exploration rights
- disposal of petroleum mining & exploration rights
- economic rights & entitlements
- farm-out arrangements
- GST farm-in, farm-out
- GST mining & energy
- mining & exploration rights
- mining & petroleum
- mining property
- non-cash benefits
- petroleum mining & exploration rights

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