MT 2012/1 - Miscellaneous taxes: application of the income tax and GST laws to immediate transfer farm-out arrangements

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Miscellaneous Taxation Ruling

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

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What this Ruling is about

1. This Ruling sets out the Commissioner's views on the application of the income tax and goods and services tax (GST) provisions upon entry into an immediate transfer farm-out arrangement as described in paragraph 10 of this Ruling.[1]

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

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

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

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

- the actual joint venture arrangement that is in existence or that may be formed as a result of, and at the time of, entry into an immediate transfer farm-out agreement; or
- a deferred transfer farm-out arrangement. A deferred transfer farm-out arrangement is discussed in Miscellaneous Taxation Ruling MT 2012/2.[4]

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 or contributes monetary payments.

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 referred to as 'immediate transfer' and 'deferred transfer' farm-out arrangements.[8]

Immediate transfer farm-out arrangement

8. 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 agreement. 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.

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[4] MT 2012/2: application of the income tax and GST laws to deferred transfer farm-out arrangements.
[5] The term 'mining tenement' is used throughout this 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] See footnote 7.

9. In return for the transfer of the interest in the mining tenement, the farmee will undertake exploration commitments or contribute to a joint venture account on the farmor's behalf for that purpose. The farmee may also make cash payments to the farmor or to third parties to meet expenses incurred by the farmor.

Class of arrangement/scheme

10. This Ruling applies to an immediate transfer farm-out arrangement that has the following characteristics:

The farmor	***The farmee***
• Transfers a percentage interest in the mining tenement to the farmee (leaving the farmor with a reduced percentage interest in that mining tenement);[9] • May also share mining information with the farmee as part of that transfer.	Undertakes: • exploration commitments[10] which may be referable to a period of time; an amount(s); a schedule of works; or a combination thereof; or • to make cash payments to the joint venture on behalf of the farmor to meet cash calls that the farmor would otherwise be obliged to meet in respect of the farmor's retained interest in the mining tenement. May also: • make cash payments to the farmor. These payments may, or may not, be referable to the exploration costs the farmor has incurred prior to the farm-out arrangement being entered into; • make cash payments to third parties to meet expenses incurred by the farmor thereby relieving the farmor from meeting those expenses.

Other rights under the arrangement

11. This Ruling does not deal with the taxation consequences of clauses dealing with rights in relation to the interest in the mining tenement, (such as any rights relating to a reassignment of the interest in the mining tenement), that are more than merely incidental to the transfer of that interest.

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[9] The parties would typically enter into a joint venture arrangement or the farmee would become a joint venturer if such an arrangement already exists.

[10] That is, the farmee carries out the exploration or contracts other entities to carry out the exploration on its behalf. It is the farmee that incurs the exploration expenditure.

Applying this Ruling

12. This Ruling sets out the Commissioner's view on the character of immediate transfer farm-out arrangements and the income tax and GST consequences for a taxpayer flowing from that characterisation. If the characterisation of all aspects of a particular arrangement for that taxpayer is not consistent with the characterisation set out in this Ruling, this Ruling does not apply to the arrangement for that taxpayer.

13. As it is not possible to comprehensively deal with the multitude of ways in which an immediate 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 Ruling.

Ruling

Characterisation of the arrangement

14. An immediate transfer farm-out arrangement is treated for income tax and GST purposes as a sale of a percentage interest in a mining tenement by a farmor to a farmee.

15. In return for the transfer of the interest in the mining tenement, the farmor:

(i) receives a non-cash benefit in the nature of a service arising from the farmee undertaking exploration commitments. The farmee may either carry out the exploration itself or contract a third party to carry out the exploration on its behalf. In this Ruling, the provision of this non-cash benefit is referred to as the provision of an 'exploration benefit'; or

(ii) is taken to receive (that is, constructively receive) cash payments made by the farmee to a joint venture to meet cash calls to fund exploration and other services or expenses or obligations that the farmor would otherwise be required to meet in respect of the farmor's retained interest in the mining tenement (that is, it is a 'free carry' for the farmor).[11]

[11] The farmor will typically get a contractual right for the farmee to make these payments.

16. In addition to the non-cash benefit or cash payments mentioned in paragraph 15, the farmor may also:

(i) receive cash payments made by the farmee to the farmor; or

(ii) be taken to receive (that is, constructively receive) cash payments made by the farmee to third parties to meet expenses incurred by the farmor thereby relieving the farmor from meeting those expenses.

17. If the circumstance in paragraph 15(i) applies, the farmee's provision of the exploration benefit to the farmor is for reward to the extent that the exploration benefit secures for the farmee the transfer of the interest in the mining tenement. The Ruling proceeds on the basis that the provision of the exploration benefit by the farmee is on revenue account.[12]

Mining information

18. Mining information[13] shared by the farmor with the farmee on entering into the agreement is treated as a non-cash benefit separate to the transfer of the interest in the mining tenement 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, which will give rise to tax consequences.

19. 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 is merely incidental to the transfer of the interest in the mining tenement rather than the provision of a non-cash benefit. In this case, the farmor's sharing of mining information with the farmee will not give rise to additional income tax or GST consequences.

20. Additionally, the farmee sharing mining information with the farmor does not give rise to additional income tax or GST consequences if that information arises from the farmee's exploration and is merely a part of the exploration benefit.[14]

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[12] This is discussed further at paragraphs 132 to 134 of this Ruling.
[13] The term 'mining information' is used throughout this Ruling as a reference to *mining, quarrying or prospecting information* as defined in subsection 995-1(1) of the ITAA 1997.
[14] This is discussed further at paragraphs 129 to 131 of this Ruling.

Market valuation

21. If the parties are dealing with each other at arm's length, it is accepted that the market value of the exploration benefit provided by the farmee or other non-cash benefit by the farmee and any cash payments made to, or on behalf of, the farmor by the farmee is equal to the market value of the interest in the mining tenement and any other benefits that are provided by the farmor.[15]

22. 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, or any non-cash benefit, is at the time of entering into the farm-out agreement.

23. The market valuation must take into account all the facts and surrounding circumstances.[16] The value of an exploration benefit provided by the farmee to the farmor does not necessarily equate with the amount to be spent by the farmee on exploration. The value of the right to require an amount to be paid where the amount is unascertainable, or where payment is contingent on the happening of a certain event, must take into account the likelihood of the amount being paid, or the event happening.

Application of the UCA provisions to the farmor

Balancing adjustment event

24. 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 section 40-40 of the ITAA 1997.[17]

25. 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.

26. 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[18] along with a reasonable proportion of any other capital costs involved in splitting the asset.[19]

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[15] This is consistent with Goods and Services Tax Ruling GSTR 2001/6: non-monetary consideration (paragraphs 19 and 138 of that Ruling).
[16] This is discussed further at paragraphs 95 to 103 of this Ruling.
[17] When the farmee begins to hold the interest in the mining tenement under the table in section 40-40 of the ITAA 1997 is discussed at paragraphs 34 to 39 and 123 to 128 of this Ruling.
[18] The two assets being the interest the farmor retains and the interest the farmor transfers to the farmee.
[19] Section 40-205 of the ITAA 1997.

27. The termination value of the interest in the mining tenement transferred by the farmor is the sum of the following so far as is applicable to the particular arrangement:

- if paragraph 15(i) of this Ruling applies, the market value of the exploration benefit received (a non-cash benefit received);[20]
- if paragraph 15(ii) or 16(ii) of this Ruling applies:
  - the amount of any cash payments to be made by the farmee that meet the farmor's joint venture expenses, or cash payments to other parties on the farmor's behalf, if the amounts are not contingent and are able to be ascertained (a right granted to receive an amount);[21] or
  - the market value of a right to require a cash payment or payments, to be paid by the farmee on the farmor's behalf to the joint venture, or to other parties, if each payment is contingent and/or the amount of each payment is unascertainable at the time of the balancing adjustment event (a non-cash benefit received);[22]
- if paragraph 16(i) of this Ruling applies, a cash payment received by the farmor from the farmee (an amount received).[23]

Exploration or prospecting expenditure deductions if paragraph 15(i) applies

28. The interest in the mining tenement that the farmor transfers to the farmee is in return for exploration or prospecting to the extent that the transfer of the interest secures the exploration benefit for the farmor. The farmor is, therefore, entitled to a deduction to that extent under subsection 40-730(1)[24] of the ITAA 1997.

29. The amount of the deduction is equal to the market value of the interest in the mining tenement at the time of entry into the farm-out agreement to the extent that the interest in the mining tenement secures the exploration benefit for the farmor.

[20] See item 4 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[21] See item 3 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[22] See item 4 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[23] See item 1 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[24] 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.

30. The deduction is allowed in the income year in which the expenditure is incurred. This is the income year in which the immediate transfer farm-out agreement is executed on the basis that the farmor has an obligation to transfer the interest in the mining tenement at that time.[25] This is illustrated by Example 1 at paragraph 71 of this Ruling.

Exploration or prospecting expenditure deductions if paragraph 15(ii) applies (that is, it is a 'free-carry' arrangement)

31. If a farm-out agreement incorporates a 'free-carry' by the farmee of the farmor's retained interest in the mining tenement, the farmor transfers the interest in the mining tenement to the farmee in return for the farmee meeting some or all of the farmor's obligations to contribute to the joint venture when joint venture cash calls are made.

32. The farmor is entitled to a deduction under subsection 40-730(1)[26] of the ITAA 1997 to the extent that the farmor's contribution[27] to the joint venture is expended on exploration or prospecting. The joint venture operator effectively incurs the expenditure on behalf of each joint venture participant that contributes to the joint venture.

33. The deduction is allowed in an income year to the extent that the joint venture operator incurs the expenditure on exploration or prospecting in that income year.[28] This is illustrated by Example 2 at paragraph 75.

Application of the UCA provisions to the farmee

Decline in value deduction for the interest in the mining tenement

When the farmee begins to hold the interest in the mining tenement

34. 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 farm-out agreement is executed if at that time the farmee:

- exercises, or has a right to exercise immediately, the rights[29] in relation to the interest in the mining tenement; and

[25] This is discussed further at paragraphs 110 to 121 of this Ruling.
[26] This is if all 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.
[27] That is, any contribution the farmor directly makes to the joint venture account to meet cash calls plus any contribution the farmee makes to the joint venture account on the farmor's behalf.
[28] The Ruling assumes an accruals basis.
[29] 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 on behalf of other participants).

- has a right to become the legal owner of the interest in the mining tenement and there is a reasonable expectation that legal ownership will transfer to the farmee.

35. Whether this is the case will depend on the particular facts and circumstances.

36. If the agreement provides that activities on the mining tenement cannot be carried out by the farmee until the requisite approvals under any applicable legislation have been obtained then, until those approvals have been obtained, the farmee cannot exercise, or have a right to exercise immediately, the subject matter of the interest in the mining tenement. As such, the farmee will not begin 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 agreement is executed.

37. In addition, if the farmee does not have a right to become the legal owner of the interest in the mining tenement until requisite approvals under any applicable legislation have been obtained, then the farmee will not begin 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 agreement is executed.

38. However, if the completion of the agreement is conditional on obtaining Ministerial approval to change title to the interest in the mining tenement, these circumstances of themselves do 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 agreement is executed.

39. When the farmee becomes the legal owner of the interest in the mining tenement, the farmee begins to hold the interest in the mining tenement under item 10 of the table in section 40-40 of the ITAA 1997.[30]

The cost of the interest in the mining tenement

40. 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.[31]

The amount of the decline in value of the interest in the mining tenement

41. 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.[32]

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[30] This is discussed further at paragraphs 123 to 128 of this Ruling.
[31] See items 1, 2 and 4 of the table in paragraph 40-185(1)(b) of the ITAA 1997.
[32] See subsection 40-25(1) of the ITAA 1997.

42. 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, and all of the requirements of subsection 40-80(1) of the ITAA 1997 are satisfied, the decline in value deduction for the farmee is the cost of the interest.[33] 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.[34] That is, the deduction is allowed in the income year in which the interest in the mining tenement is first used for exploration or prospecting.

43. If the interest in the mining tenement 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 subsection 40-25(1) of the ITAA 1997.

Exploration or prospecting expenditure deductions

44. The farmee is entitled to a deduction for expenditure incurred on exploration or prospecting under subsection 40-730(1)[35] of the ITAA 1997. The deduction is allowed in the income year in which the expenditure is incurred.

Deduction for expenditure on mining information

45. If the parties have identified consideration provided by the farmee as being for mining information shared[36] by the farmor with the farmee, then the farmee may be entitled to a decline in value deduction under subsection 40-25(1)[37] of the ITAA 1997 or a deduction under subsection 40-730(1) of the ITAA 1997 for the expenditure incurred on the mining information if the requirements of the provision are satisfied.

[33] The effect of subsection 40-80(1) of the ITAA 1997 as it applies to subsection 40-25(1) of the ITAA 1997.
[34] Section 40-60 of the ITAA 1997.
[35] This is if all 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.
[36] That is, the farmor continues to hold that mining information.
[37] The decline in value deduction for the farmee is the cost of the interest in the mining tenement if all of the requirements of subsection 40-80(1) of the ITAA 1997 have been satisfied.

Application of the CGT provisions

CGT consequences for the farmor – applicable whether paragraph 15(i) or 15(ii) applies

46. CGT event A1 happens[38] to the farmor for the interest in the mining tenement that is transferred by the farmor to the farmee.[39] However, subsection 118-24(1) of the ITAA 1997 applies to disregard any capital gain or capital 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.

47. The farmor may also acquire a right to require the interest in the mining tenement to be reassigned to the farmor if the farmee does not meet its exploration or payment commitments. On the basis that capital proceeds are not attributable to this right, and it is merely incidental to the transfer of the interest in the mining tenement, there are no additional CGT consequences for the farmor.

Additional CGT consequences for the farmor if paragraph 15(ii) applies (that is, it is a 'free-carry' arrangement)

48. If a farm-out agreement incorporates a 'free carry' by the farmee of the farmor's retained interest in the mining tenement, the farmor may acquire a right, when the farm-out agreement is executed, for the farmee to meet the farmor's share of future exploration expenses of the joint venture if any cash payments by the farmee are contingent and/or unascertainable at that time. In that case, CGT event C2[40] happens for the farmor when the farmee makes a cash payment to the joint venture in satisfaction, or partial satisfaction, of that right. The cost base of the right is so much of the market value of the interest in the mining tenement (and any other benefits) provided by the farmor to secure that right provided by the farmee.

49. If a cash payment is made by the farmee to the joint venture on the farmor's behalf in full satisfaction of that right, that cash payment gives rise to a capital gain to the extent that the payment exceeds the cost base of that right. If there is more than one cash payment made by the farmee, each payment is made in partial satisfaction of that right. In this case, the cost base of that right is reduced proportionally[41] and each payment gives rise to a capital gain to the extent that the payment exceeds the proportionate cost base of that right.

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[38] See subsection 104-10(3) of the ITAA 1997 as to when the event happens.
[39] Section 104-10 of the ITAA 1997.
[40] Section 104-25 of the ITAA 1997.
[41] Subsection 112-30(3) of the ITAA 1997.

CGT consequences for the farmee – applicable whether paragraph 15(i) or 15(ii) applies

50. The farmee acquires a CGT asset (being the interest in the mining tenement). However, this is likely to be of no practical consequence for the farmee if the UCA provisions apply to any subsequent dealing by the farmee with that interest (see paragraph 46 of this Ruling as to the interaction of the UCA and CGT provisions in relation to the farmor).

51. The farmee may also acquire a right to reassign the interest in the mining tenement to the farmor if, for example, exploration reveals insufficient quantities of minerals. On the basis that no cost is attributable to this right, and it is merely incidental to the acquisition of the interest in the mining tenement, there are no additional CGT consequences for the farmee.

Additional CGT consequences for the farmee if paragraph 15(ii) applies (that is, it is a 'free-carry' arrangement)

52. Under a 'free-carry' arrangement, the farmee creates a right in the farmor when the farm-out agreement is entered into (see paragraph 48 of this Ruling). CGT event D1[42] happens for the farmee when the farm-out agreement is entered into as this is the time when the right is created. The capital proceeds for that right is so much of the market value of the interest in the mining tenement (and any other benefits) provided by the farmor to secure that right. The farmee makes a capital gain to the extent that the capital proceeds for that right exceeds its incidental costs.

Application of the ordinary income and deduction provisions

Farmor sharing mining information for identified consideration

53. If the parties have identified consideration provided by the farmee as being for mining information shared[43] by the farmor with the farmee on entering into the agreement, the consideration is assessable income of the farmor under section 6-5 or 15-40 of the ITAA 1997.

54. 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).[44]

[42] Section 104-35 of the ITAA 1997.
[43] That is, the farmor continues to hold that information.
[44] This is discussed further at paragraphs 129 to 131 of this Ruling.

Farmee's reward for providing the exploration benefit

55. To the extent that the interest in the mining tenement received by the farmee is reward for the provision of the exploration benefit (a non-cash benefit in the nature of a service) 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 or 15-2 of the ITAA 1997.

56. It is assessable income in an income year to the extent that there is a provision of an exploration benefit to the farmor in that income year.[45]

Farmee's exploration related expenditure

57. Expenditure by the farmee that relates to exploration by the farmee 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 the other requirements of section 8-1 of the ITAA 1997 are satisfied. An example is salary or wages of employees involved in general administration work for the farmee. The deduction is allowed in the income year in which the expenditure is incurred.

Application of the GST provisions

58. Under the terms of an immediate transfer farm-out arrangement, there is a supply[46] by the farmor to the farmee of an interest in a mining tenement.

59. If the farmor's supply of the interest in the mining tenement is for non-monetary consideration only (that is, the exploration benefit), it is a barter transaction. The farmee also makes a supply to the farmor of the exploration benefit for non-monetary consideration.

60. On the basis of it being an arm's length transaction, the GST-inclusive market value of the exploration benefit to the farmor is equal to the GST-inclusive market value of the interest in the mining tenement that is transferred to the farmee.[47] The farmor and the farmee each make a taxable supply[48] and a creditable acquisition.[49]

61. If consideration for the farmor's supply of the interest in the mining tenement consists of both monetary and non-monetary consideration, the market value of the farmor's and the farmee's supplies can be worked out as explained at paragraphs 21 to 23 of this Ruling.

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[45] This is discussed further at paragraphs 132 to 134 of this Ruling.
[46] Section 9-10 of the GST Act.
[47] See paragraph 138 of GSTR 2001/6.
[48] Assuming the requirements of section 9-5 of the GST Act are satisfied and it is not part of a supply that is a GST-free supply of a going concern.
[49] Assuming the requirements of section 11-5 of the GST Act are satisfied.

62. Monetary consideration is provided by the farmee to the farmor for the supply of the interest in the mining tenement if the farmee:

- makes cash payments to the farmor; or
- makes cash payments to third parties to meet expenses incurred by the farmor thereby relieving the farmor from meeting those expenses; or
- makes cash payments to the joint venture account on the farmor's behalf under a 'free-carry' arrangement.[50] This includes where the consideration is, for example, expressed as being 10% of exploration costs subject to a maximum of $1,100,000.[51]

Mining information

63. 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 agreement, that sharing 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. The farmor makes a taxable supply of that mining information and it is a creditable acquisition for the farmee.

Attribution rules

64. Assuming total consideration is known at the time of the supply, the basic attribution rules under Division 29 of the GST Act apply.[52] To claim an input tax credit, the recipient must hold a tax invoice. If a tax invoice is not held, the input tax credit is attributable to a tax period when a tax invoice is held and the input tax credit is claimed.[53]

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[50] The GST consequences in relation to a 'free-carry' arrangement are illustrated in Example 2 at paragraph 75 of this Ruling.

[51] This is 'expressed as an amount of money' for the purposes of paragraph 9-75(1)(a) of the GST Act and is consistent with GST Ruling GSTR 2001/6 (see paragraph 43 of that Ruling).

[52] These rules are further explained in paragraphs 13 to 45 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. So far as the consideration is non-monetary, see paragraphs 166 to 197 of Goods and Services Tax Ruling GSTR 2001/6 Goods and services tax: non-monetary consideration.

[53] See subsections 29-10(3) and (4) of the GST Act. Under Division 93 of the GST Act, an entitlement to an input tax credit for a creditable acquisition may cease if the input tax credit is 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.

65. If total consideration is not known, and the farmor or the farmee accounts for GST on a non-cash basis, the attribution rules under *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000* apply instead of the basic attribution rules.[54]

The net GST outcome

66. Assuming both the farmor and farmee are registered for GST and account on a non-cash basis, they can claim any input tax credits as soon as they hold a tax invoice from the other party.

67. If the consideration for the supply of the interest in the mining tenement is monetary and non-monetary, the farmor will have a net GST payable position and the farmee will have a net GST refund position to the extent that the consideration for the supply of the interest in the mining tenement is monetary. This outcome is illustrated by Example 1 at paragraph 71 of this Ruling.

68. If the farmee's consideration is non-monetary only, it is a barter transaction. For each entity, the GST payable and input tax credit will offset each other giving rise to a nil net GST outcome (assuming the acquisition by each party is for a fully creditable purpose).[55]

GST going concern

69. Paragraph 195 of Goods and Services Tax Ruling GSTR 2002/5[56] explains that it is possible for an entity in a joint venture[57] to make a GST-free 'supply of a going concern', including when part of the enterprise conducted by the joint venturer is supplied. This is providing all of the requirements of section 38-325 of the GST Act, as explained in GSTR 2002/5, are satisfied.

70. 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 have no 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 benefit to the farmor and the farmor may be entitled to input tax credits.

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[54] This is further explained in Goods and Services Tax Ruling GSTR 2000/29 at paragraphs 92 to 98; and 147 to 170.

[55] This outcome differs if the supply by the farmor to the farmee is part of a supply that is a GST-free supply of a going concern. See paragraphs 69 and 70 of this Ruling.

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

[57] 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?

Examples

Example 1 – farmor receives a cash payment and an exploration benefit

71. The facts for this example are as follows:

- Farmor Co holds a 100% interest in a mining tenement.
- The mining tenement is at the exploration stage and has no adjustable value for income tax purposes (that is, a deduction has previously been claimed in full for the cost of the mining tenement by Farmor Co under subsection 40-25(1) of the ITAA 1997 applying subsection 40-80(1) of the ITAA 1997.
- Farmor Co and Farmee Co enter into an immediate transfer farm-out agreement. The parties are dealing with each other at arm's length. Farmor Co agrees to transfer a 90% interest in the mining tenement to Farmee Co under the agreement, leaving Farmor Co with a 10% interest.
- Farmor Co shares mining information with Farmee Co, but separate consideration is not identified for that element of the arrangement.
- Farmee Co agrees to complete all of the exploration to the value of $880,000 (GST-inclusive) on the mining tenement over the next 3 years. It is assumed that all expenditure relates to exploration or prospecting for minerals or quarry materials for the purposes of carrying on 'mining operations'.[58]
- Farmee Co agrees to pay Farmor Co $110,000 (GST-inclusive) upon signing the agreement.
- The market value of the 90% interest in the mining tenement is $132,000 (GST-inclusive). This market value 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 Farmor Co is $22,000 (GST-inclusive).[59]

[58] See definition of 'mining operations' in subsection 40-730(7) of the ITAA 1997.
[59] Worked out as $132,000 market value of the 90% interest in the mining tenement reduced by the $110,000 cash payment that relates to the acquisition of that interest in the mining tenement.

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

73. The income tax consequences for Farmor Co and Farmee Co are summarised in Table 1 that follows. It is assumed that:

- if mention is made of subsection 40-730(1) of the ITAA 1997 – all of the other requirements of subsection 40-730(1) of the ITAA 1997 are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply; and
- if mention is made of any other provision – all of the requirements of that provision are satisfied.

Table 1 – Income tax – Farmor Co and Farmee Co

Event	**Assessable/ (Deductible)** **All legislative references are to the ITAA 1997; all amounts are GST-exclusive**	**Timing**
Farmor Co		
1 – In return for Farmor Co transferring a 90% interest in the mining tenement to Farmee Co, Farmor Co receives a cash payment and an exploration benefit.	$100,000 under item 1 of the table in paragraph 40-305(1)(b) $20,000 under item 4 of the table in paragraph 40-305(1)(b) (see paragraph 27)	When Farmee Co begins to hold the interest in the mining tenement. (see paragraphs 34 to 39)
2 – Farmor Co expends the 90% interest in the mining tenement partly in return for the exploration benefit.	($20,000) subsection 40-730(1) (see paragraphs 28 and 29)	When the farm-out agreement is executed on the basis that Farmor Co has an obligation to transfer the interest in the mining tenement. (see paragraph 30)
Net income tax outcome for Farmor Co	**$100,000** Farmor Co is effectively assessed on the $100,000 cash payment it receives.	

Event	Assessable/ (Deductible) All legislative references are to the ITAA 1997; all amounts are GST-exclusive	Timing
Farmee Co		
3 – Farmee Co makes a cash payment and provides an exploration benefit to Farmor Co in return for the 90% interest in the mining tenement.	($100,000) under item 1 of the table in paragraph 40-185(1)(b) ($20,000) under item 4 of the table in paragraph 40-185(1)(b) $120,000 is the first element of cost of the interest in the mining tenement and immediately deductible if Farmee Co's 90% interest is first used for exploration or prospecting: subsections 40-25(1) and 40-80(1) (see paragraphs 40 to 43)	When Farmee Co's interest in the mining tenement is first used for exploration or prospecting if it is immediately deductible. Alternatively, when the interest in the mining tenement starts to decline in value under subsection 40-25(1). (see paragraphs 40 to 43)
4 – Farmee Co provides an exploration benefit (on revenue account) to Farmor Co for which Farmee Co earns part of its 90% interest in the mining tenement	$20,000 section 6-5 or 15-2 $20,000 of the interest in the mining tenement earned by the Farmee Co is attributable to its provision of the exploration benefit (see paragraphs 55 and 56)	To the extent that Farmee Co provides an exploration benefit to Farmor Co in an income year.[60] (see paragraph 56)
5 – Farmee Co incurs exploration expenditure in the course of undertaking the exploration it committed to under the agreement.	($800,000) subsection 40-730(1) or section 8-1 (see paragraphs 44 and 57)	When the expenditure is incurred. (see paragraphs 44 and 57)
Net income tax outcome for Farmee Co	**($900,000)**	

[60] *Arthur Murray (*NSW*) Pty Ltd v. FC of T* (1965) 114 CLR 314; 9 AITR 673; 14 ATD 98.

74. The GST consequences for Farmor Co and Farmee Co are summarised in Table 2 that 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.

Table 2 – GST outcomes for Farmor Co and Farmee Co

Event	**GST payable/input tax credits (ITCs)**	**Attribution to a tax period (non-cash basis)**
Farmor Co		
1 – Farmor Co makes a taxable supply of the 90% interest in the mining tenement to Farmee Co.	GST payable of $12,000 (1/11th of $132,000 GST-inclusive) (see paragraphs 58 to 62)	When an invoice is issued or any of the consideration is received, whichever is earlier. (see paragraphs 64 and 65)
2 – Farmor Co makes a creditable acquisition of an exploration benefit.	ITC entitlement of ($2,000) (1/11th of $22,000 GST-inclusive) (see paragraphs 58 to 62)	When any of the consideration is provided by Farmor Co and Farmor Co holds a tax invoice; or an invoice that is also a tax invoice is issued by Farmee Co to Farmor Co for the exploration benefit. (see paragraphs 64 and 65)
Net GST outcome for Farmor Co	$10,000 GST payable (relates to the cash payment received)	

Event	GST payable/input tax credits (ITCs)	Attribution to a tax period (non-cash basis)
Farmee Co		
3 – Farmee Co makes a taxable supply of an exploration benefit to Farmor Co.	GST payable of $2,000 (1/11th of $22,000 GST-inclusive) (see paragraphs 58 to 62)	When an invoice is issued or any of the consideration is received, whichever is earlier. (see paragraphs 64 and 65)
4 – Farmee Co makes a creditable acquisition of the 90% interest in the mining tenement.	ITC entitlement of $12,000 (1/11th of $132,000 GST-inclusive) (see paragraphs 58 to 62)	When any of the consideration is provided by Farmee Co and Farmee Co holds a tax invoice; or an invoice that is also a tax invoice is issued by Farmor Co to Farmee Co for the interest in the mining tenement. (see paragraphs 64 and 65)
Net GST outcome for Farmee Co	($10,000) net GST refund (relates to the cash paid)	

Example 2 – farmor receives a cash payment and a 'free carry' by the farmee

75. The facts for this example are as follows:

- Farmor 2 Co holds a 100% interest in a mining tenement.
- The mining tenement is at the exploration stage and has no adjustable value for tax purposes (that is, a deduction has previously been claimed in full for the cost of the mining tenement by Farmor 2 Co under subsection 40-25(1) of the ITAA 1997 applying subsection 40-80(1) of the ITAA 1997.
- On 1 July 2011, Farmor 2 Co and Farmee 2 Co enter into an immediate transfer farm-out agreement and establish a joint venture. The parties are dealing with each other at arm's length. Farmor 2 Co agrees to transfer a 90% interest in the mining tenement to Farmee 2 Co under the agreement, leaving Farmor 2 Co with a 10% interest.

- Farmor 2 Co shares mining information with Farmee 2 Co, but separate consideration is not identified for that element of the arrangement.
- Farmee 2 Co agrees to pay Farmor 2 Co $110,000 cash (GST-inclusive) upon signing the agreement.
- In the 2011-12 income year (that is 1 July 2011 to 30 June 2012), Farmee 2 Co also agrees to contribute and does contribute $880,000 (GST-inclusive) to the joint venture account to meet planned exploration or prospecting expenditure for that income year. Therefore, of this amount, $88,000 is contributed on behalf of Farmor 2 Co. To the extent this relieves Farmor 2 Co from having to contribute that amount it is a 'free-carry' for Farmor 2 Co. The whole of Farmee 2 Co's joint venture contribution in the 2011-12 income year is expended in that year by the joint venture operator on exploration or prospecting for minerals or quarry materials obtainable by mining operations.
- In the 2012-13 income year (that is 1 July 2012 to 30 June 2013), Farmee 2 Co also agrees to make further contributions, to a maximum of $1,100,000 GST-inclusive, to meet its share of the joint venture expenditure as well as Farmor 2 Co's share of the expenditure. To the extent this relieves Farmor 2 Co from having to contribute any amounts, it is also a 'free-carry' for Farmor 2 Co. However, whether any payments will be made and the amount of those payments is subject to decisions to be made by the joint venturers in the 2011-12 income year based on exploration findings. Having regard to the likelihood of the payments being made on Farmor 2 Co's behalf, and the maximum amount of any such payments, Farmor 2 Co's right against Farmee 2 Co to have such amounts paid has a market value of $1,100 (GST-inclusive).
- Farmee 2 Co retains the right to the funds contributed to the joint venture account until they are expended by the joint venture operator.
- In the 2012-13 income year, Farmee 2 Co receives a cash call to contribute a further $220,000 (GST-inclusive) to the joint venture account for exploration expenses incurred by the joint venture operator in that income year. Therefore, of this amount, $22,000 is contributed on behalf of Farmor 2 Co.
- No further cash calls are made upon the joint venturers.

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

77. The income tax consequences for Farmor 2 Co and Farmee 2 Co are summarised in Table 3 that follows. It is assumed that:

- if mention is made of subsection 40-730(1) of the ITAA 1997 – all of the other requirements of subsection 40-730(1) of the ITAA 1997 are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply;
- if mention is made of any other provision – all of the requirements of that provision are satisfied.

Table 3 – Income tax – Farmor 2 Co and Farmee 2 Co

Event	**Assessable/ (Deductible)** **All legislative references are to the ITAA 1997; all amounts are GST-exclusive**	**Timing**
Farmor 2 Co		
1 – In return for Farmor 2 Co transferring a 90% interest in the mining tenement to Farmee 2 Co, Farmor 2 Co receives a cash payment, a right to (constructively) receive a cash payment and an exploration benefit.	$100,000 under item 1 of the table in paragraph 40-305(1)(b) $80,000[61] under item 3 of the table in paragraph 40-305(1)(b) $1,000[62] under item 4 of the table in paragraph 40-305(1)(b) (see paragraph 27)	When Farmee 2 Co begins to hold the interest in the mining tenement. (see paragraphs 34 to 39)

[61] 10% of $800,000 paid by Farmee 2 Co to the joint venture to meet Farmor 2 Co's share of the exploration and prospecting expenses of the joint venture.
[62] The market value of Farmor 2 Co's right to have its share of possible future joint venture exploration and prospecting expenses met by Farmee 2 Co.

Event	**Assessable/ (Deductible)** **All legislative references are to the ITAA 1997; all amounts are GST-exclusive**	**Timing**
2 – Expenditure is incurred on exploration or prospecting through the joint venture, although met by Farmee 2 Co on Farmor 2 Co's behalf.	($80,000) subsection 40-730(1) (see paragraphs 31 to 33)	In the 2011-12 income year, when the expenditure is incurred by the joint venture operator. (see paragraph 33)
Net income tax outcome for Farmor 2 Co for the 2011-12 income year	**$101,000**	
3 – Farmor 2 Co receives a cash payment contributed by Farmee 2 Co on its behalf and expended by the joint venture operator. This cash payment is in full satisfaction of the right.	$19,000 subsection 102-5(1) CGT event C2 happens under section 104-25. $20,000 capital proceeds less $1,000 cost base of the right. (see paragraphs 48 and 49)	When the joint venture operator expends Farmee 2 Co's further contribution to the joint venture and the right ends. (see paragraphs 48 and 49)
4 – Expenditure is incurred in meeting the exploration or prospecting expenses of the joint venture.	($20,000)[63] subsection 40-730(1) (see paragraphs 31 to 33)	In the 2012-13 income year, when the expenditure is incurred by the joint venture operator. (see paragraph 33)
Net income tax outcome for Farmor 2 Co for the 2012-13 income year	**($1,000)**	
Overall income tax outcome for Farmor 2 Co	**$100,000 taxable income**	

[63] 10% of $200,000 paid by Farmee 2 Co to the joint venture to meet Farmor 2 Co's share of the exploration and prospecting expenses of the joint venture.

Event	Assessable/ (Deductible) All legislative references are to the ITAA 1997; all amounts are GST-exclusive	Timing
Farmee 2 Co		
5 – Farmee 2 Co makes a cash payment to Farmor 2 Co and to the joint venture and provides a non-cash benefit to Farmor 2 Co to the extent that a future payment(s) is contingent or the amount unascertainable. This is in return for the 90% interest in the mining tenement.	($100,000) under item 1 of the table in paragraph 40-185(1)(b) ($80,000) under item 2 of the table in paragraph 40-185(1)(b) ($1,000) under item 4 of the table in paragraph 40-185(1)(b) $181,000 is the first element of cost of the interest in the mining tenement and immediately deductible if Farmee 2 Co's 90% interest is first used for exploration or prospecting: subsections 40-25(1) and 40-80(1) (see paragraphs 40 to 43)	When Farmee 2 Co's interest in the mining tenement is first used for exploration or prospecting if it is immediately deductible. Alternatively, when the interest in the mining tenement starts to decline in value under subsection 40-25(1). (see paragraphs 40 to 43)
6 – Farmee 2 Co creates a contractual right in Farmor 2 Co for Farmee 2 Co to meet future joint venture cash calls that are contingent and the amounts unascertainable at the time of entering into the agreement. The capital proceeds for that right is so much of the interest in the mining tenement that relates to that right.	$1,000 subsection 102-5(1) CGT event D1 happens under section 104-35. $1,000 assessable capital gain assuming that there are no incidental costs. (see paragraph 52)	When Farmee 2 Co enters into the farm-out agreement as this is when the right is created. (see paragraph 52)

Event	**Assessable/ (Deductible)** **All legislative references are to the ITAA 1997; all amounts are GST-exclusive**	**Timing**
7 – Expenditure is incurred in meeting the exploration or prospecting expenses of the joint venture.	($720,000)[64] subsection 40-730(1) or section 8-1 (see paragraphs 44 and 57)	In the 2011-12 income year when the expenditure is incurred by the joint venture operator. (see paragraphs 44 and 57)
Net income tax outcome for Farmee 2 Co for the 2011-12 income year	**($900,000)**	
8 – Expenditure is incurred in meeting the exploration or prospecting expenses of the joint venture.	($200,000) subsection 40-730(1) or section 8-1 (see paragraphs 44 and 57)	When the joint venture operator expends Farmee 2 Co's further contribution to the joint venture.(see paragraphs 44 and 57)
Net income tax outcome for Farmee 2 Co for the 2012-13 income year	**($200,000)**	
Overall income tax outcome for Farmee 2 Co	**($1,100,000) deductions**	

78. The GST consequences for Farmor 2 Co and Farmee 2 Co is summarised in Table 4 that follows. It assumes that:

- Farmor 2 Co and Farmee 2 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.

[64] Exploration costs to the extent the costs are not included in the first element of cost of the interest in the mining tenement (i.e. $800,000 - $80,000).

79. Based on the facts, total consideration is not known at the time of the supply of the interest in the mining tenement. What is the total consideration depends on future events not within Farmor 2 Co's control. Therefore, the attribution rules as set out in *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000* apply instead of the basic attribution rules.

Table 4 – GST outcomes for Farmor 2 Co and Farmee 2 Co[65]

Event	GST payable/input tax credits (ITCs)	Attribution to a tax period (non-cash basis)
Farmor 2 Co		
1 – Farmor 2 Co makes a taxable supply of the 90% interest in the mining tenement to Farmee 2 Co.	GST payable of $18,000 (1/11th of $198,000 GST-inclusive) (see paragraphs 58 to 62)	Assuming an invoice is issued for $198,000 (and any consideration received is not in excess of this amount and is not received in an earlier tax period) – the tax period in which the invoice is issued. (see paragraphs 64 and 65)
2 – Farmor 2 Co receives further consideration upon a further contribution to the joint venture by Farmee 2 Co on Farmor 2 Co's behalf.	GST payable of $2,000 (1/11th of $22,000 GST-inclusive) (see paragraphs 58 to 62)	Assuming an invoice is issued for $22,000 (and is not received in an earlier tax period) – the tax period in which the invoice is issued. (see paragraphs 64 and 65)
Net GST outcome for Farmor 2 Co	$20,000 GST payable	
Farmee 2 Co		
3 – Farmee 2 Co makes a creditable acquisition of the 90% interest in the mining tenement.	ITC entitlement of $18,000 (1/11th of $198,000 GST-inclusive) (see paragraphs 58 to 62)	The tax period in which Farmee 2 Co holds a tax invoice. (see paragraphs 64 and 65)
4 – Farmee 2 Co makes a further contribution to the joint venture on Farmor 2 Co's behalf.	ITC entitlement of $2,000 (1/11th of $22,000 GST-inclusive) (see paragraphs 58 to 62)	The tax period in which Farmee 2 Co holds a tax invoice (see paragraphs 64 and 65)
Net GST outcome for Farmee Co	($20,000) net GST refund	

[65] There will be further GST consequences for the exploration or prospecting expenditure. Whether there is a GST joint venture (Division 51 of the GST Act) will affect who is entitled to claim the input tax credits for that expenditure.

Date of effect

80. This Ruling applies to an immediate transfer farm–out arrangement[66] that is:

(a) in relation to the Commissioner's views on the application of the income tax provisions – entered into after 27 July 2011 but no later than 7.30 pm, by legal time in the Australian Capital Territory, on 14 May 2013, if the farmor started to hold the mining tenement that is the subject of the arrangement on or after 1 July 2001, and

(b) in relation to the Commissioner's views on the application of the GST provisions – entered into after 27 July 2011.

81. For the purposes of the income tax provisions:

(a) Taxation Ruling IT 2378 is relevant if the farmor started to hold the mining tenement before 1 July 2001; and

(b) Refer to the 'Immediate transfer farm-out arrangements' fact sheet for guidance on the treatment of an immediate transfer farm-out arrangement that satisfies subsection 40-1100(1) of the *Income Tax Assessment Act 1997* and is entered into after 7.30 pm, by legal time in the Australian Capital Territory, on 14 May 2013.

Commissioner of Taxation
18 April 2012

[66] It must be an immediate transfer farm-out arrangement of the type covered by this Ruling.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

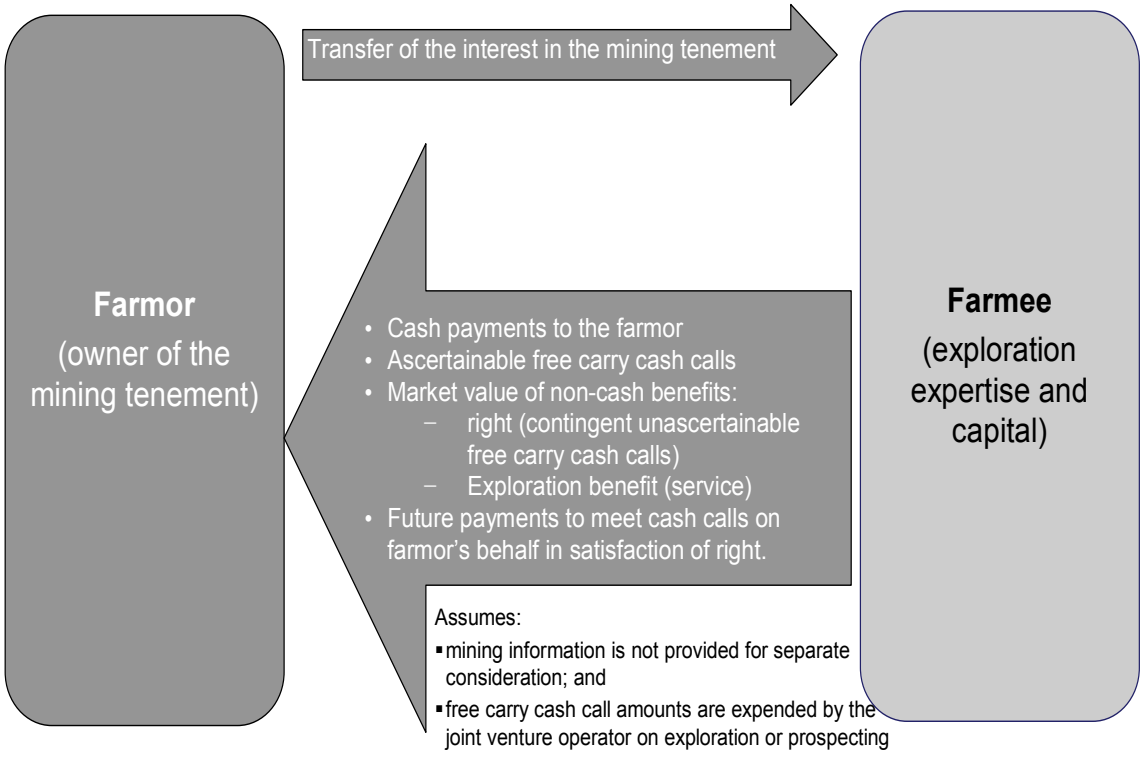
82. The Explanation section of the Ruling is set out in three Parts:

- *Part A* has diagrams summarising the Commissioner's views on the significant issues dealt with in this Ruling (paragraphs 83 and 84);
- *Part B* further explains the Commissioner's approach to certain key issues, which are relevant for the application of both the income tax and GST laws to immediate transfer farm-out arrangements (paragraphs 85 to 103); and
- *Part C* provides further explanation of the application of certain income tax provisions to immediate transfer farm-out arrangements (paragraphs 104 to 134).

Part A – Diagrammatic representation of certain key issues

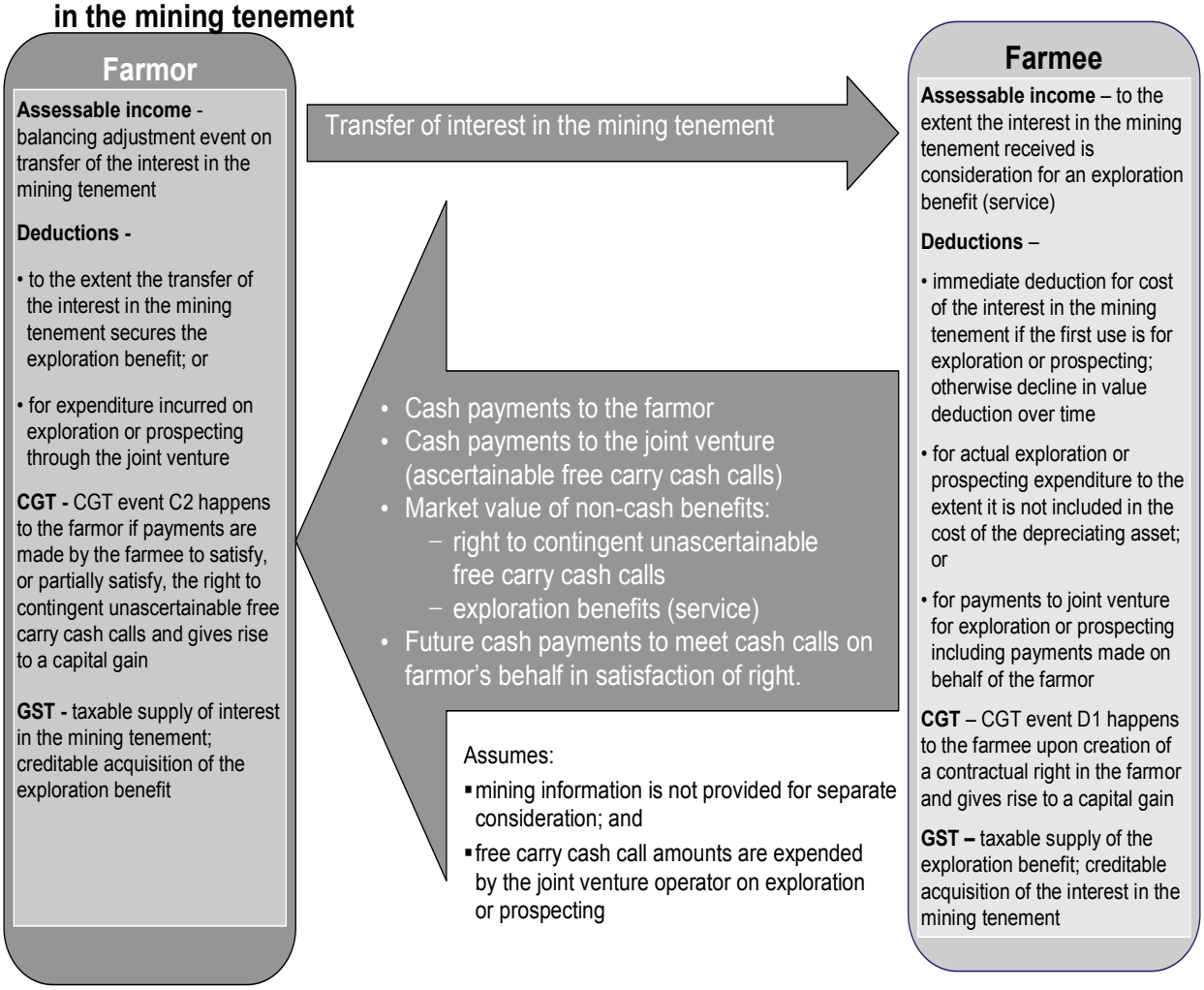
83. The following diagram illustrates the character of the things typically provided by the farmor and the farmee.

Diagram 1 - Characterisation of an immediate transfer farm-out arrangement



84. The following diagram illustrates the usual income tax and GST consequences arising from the transfer of the interest in the mining tenement. The particular tax outcomes will depend upon what the farmee is to provide in return for the transfer of the interest in the mining tenement under the particular arrangement.

Diagram 2 - Usual income tax and GST consequences from the transfer of the interest in the mining tenement



Part B – Approach to certain key issues

Exploration benefit

85. A farmee that undertakes exploration commitments (that is, whether the farmee does the exploration or contracts a third party to do the exploration) provides an exploration benefit to the farmor. For the UCA provisions, it is necessary to determine if that benefit is a non-cash benefit.

86. A *non-cash benefit* is defined in subsection 995-1(1) of the ITAA 1997 as follows:

> ***non-cash benefit*** is property or services in any form except money. If a non-cash benefit is dealt with on behalf of an entity, or is provided or dealt with as an entity directs, the benefit is taken to be provided to the entity.

87. Thus for that benefit to be a non-cash benefit as defined it must be property or services. As the benefit is not property, it is necessary to consider if it is services.

88. The term 'services' is not defined in the ITAA 1997. It therefore takes on its ordinary meaning in the context in which it appears.[67]

89. Service is defined in the Macquarie Dictionary (Fourth Edition) as:

> 1. an act of helpful activity.
>
> 2. the supplying or supplier of any articles, commodities, activities, etc., required or demanded.

90. Whether or not in the context of the definition of *non-cash benefit*, the term 'service' is intended to have the first meaning, it does have the second meaning. Further, there is nothing in the context to suggest the term 'service' as used in the definition of *non-cash benefit* should have a narrower meaning.

91. By the farmee undertaking the exploration commitments, there is the carrying out of, and the performance of, contractual obligations by the farmee. The farmee is carrying out activities required to be undertaken to meet its contractual obligations to the farmor as the interest in the mining tenement is transferred by the farmor only if the exploration commitments are satisfied. Additionally, the farmee's exploration 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.

92. Consequent upon the ordinary meaning of service, there is the provision of a service (an exploration benefit) by the farmee to the farmor that is a non-cash benefit.[68]

93. However, a reference to exploration benefit does not necessarily equate the exploration benefit with the amount to be spent by the farmee on the exploration commitments.

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[67] As expressed in *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408 per Brennan CJ, Dawson, Toohey and Gummow JJ.

[68] This is reinforced if the farmee provides information about the results of exploration to the farmor.

94. It is recognised that, as the farmee is acquiring an interest in the mining tenement, its exploration commitments are in part for its own benefit. However, the farmor is also benefiting to some extent from those exploration commitments consistent with what it has contracted for. In a typical immediate transfer farm-out agreement, the farmor's transfer of the interest in the mining tenement is executed in return for those exploration commitments and any cash payment commitments.

Market valuation

95. As explained at paragraph 21 of this Ruling, if the parties are dealing with each other at arm's length, the market value of any exploration benefit or other non-cash benefit provided by the farmee and any cash payments made to, or on behalf of, the farmor by the farmee is equal to the market value of the interest in the mining tenement and any other benefits that are provided by the farmor to the farmee.[69]

96. It is therefore necessary to consider market value[70] for both UCA and GST purposes.

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

98. 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.

99. This is based upon the common law test for market value as developed in *Spencer v. The Commonwealth.*[71] The High Court provided a summary of this test in *Abrahams v. FC of T*[72] where Williams J said (at page 29) that market value is:

> the price which a willing but not anxious vender 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…

100. 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.

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[69] This is consistent with Goods and Services Tax Ruling GSTR 2001/6: non-monetary consideration (paragraphs 19 and 138 of that Ruling).

[70] For GST purposes, it is the GST-inclusive market value of the non-monetary consideration. For UCA purposes, in determining the market value of the non-cash benefit, 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.

[71] (1907) 5 CLR 418.

[72] (1944) 70 CLR 23.

101. If the farm-out agreement specifies the market value of the interest in the mining tenement, then that value would be part of the evidence to be taken into account in determining the market value of the interest in the mining tenement.

102. Further, 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.

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

Part C – application of the income tax law

104. This Part provides further explanation for:

- the application of the UCA provisions; and
- the application of sections 6-5, 15-2 and 15-40 of the ITAA 1997.

Application of the UCA provisions

105. A 'mining, quarrying or prospecting right' is a depreciating asset[73] and includes an interest in the relevant authority, licence, permit, right or lease.[74] The interest in the mining tenement held by the farmor is therefore a depreciating asset.

106. 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 an immediate transfer farm-out arrangement such as to determine the deductibility of certain expenditure incurred by the farmor and farmee.

Splitting of the mining tenement

107. When the farmor transfers part of their 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.[75]

108. 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.

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[73] See paragraph 40-30(2)(a) of the ITAA 1997.
[74] See paragraph (c) of the definition of *mining, quarrying or prospecting right* in subsection 995-1(1) of the ITAA 1997.
[75] Section 40-115 of the ITAA 1997.

109. No balancing adjustment event occurs by reason only of the split into the two depreciating assets.[76] A balancing adjustment event does, however, occur for the interest in the mining tenement transferred by the farmor to the farmee.[77]

Exploration or prospecting expenditure deductions

110. 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 is in the business of exploration or prospecting.

111. Consistent with the view that the farmor transfers the interest in the mining tenement to the farmee in return (at least to some extent)[78] for the provision of the exploration benefit by the farmee, it can be said that the farmor transfers the interest in the mining tenement to the farmee to secure those benefits.

112. For the transfer of the interest in the mining tenement by the farmor to be deductible to the farmor under subsection 40-730(1) of the ITAA 1997, it must constitute expenditure incurred by the farmor.

113. The term ‘expenditure’ is not defined in the ITAA 1997. It therefore takes on its ordinary meaning in the context in which it appears.[79]

114. Expenditure is defined in the *Macquarie Dictionary* (Fourth edition) as 'the act of expending, disbursement or consumption'. Similarly, the *Australian Concise Oxford Dictionary* (Fourth Edition) defines expenditure as 'the process or an instance of spending or using up'.

115. In the context in which the term ‘expenditure’ appears in subsection 40-730(1) of the ITAA 1997, the farmor has disbursed, consumed, or used up the interest in the mining tenement by transferring it to the farmee. As such, that disbursement, consumption or using up of the interest in the mining tenement can be said to be expenditure for the purposes of subsection 40-730(1) of the ITAA 1997.

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[76] Subsection 40-295(3) of the ITAA 1997.
[77] Subsection 40-295(1) of the ITAA 1997.
[78] That is, it might also be provided in return for cash payments.
[79] As expressed in *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408 per Brennan CJ, Dawson, Toohey and Gummow JJ.

116. Support for this view can be found in *Oram (Inspector of Taxes) v. Johnson*[80] where Walton J states:

> So I return to basically to para 4(1)*(b)*, 'the amount of any expenditure'. It seems to me that, although one does in general terms talk about expenditure of time and expenditure of effort, having regard particularly to the opening words of para 4(1), where the expenditure is to be a 'deduction', the primary matter which is thought of by the legislature in para 4(1)(*b)* is ***something which is passing out from the person*** who is making the expenditure. ***That will most normally and naturally be money***, accordingly presenting no problems in calculation; ***but that will not necessarily be the case***. I instance the case (it may be fanciful, but I think it is a possible one and tests the principle) of the taxpayer employing a bricklayer to do some casual bricklaying about the premises, the remuneration for the bricklayer being three bottles of whisky at the end of the week. It seems to me that that would be expenditure by the taxpayer, because out of his stock he would have to give something away to the person who was laying the bricks, and I do not think that that would present any real problems of valuation or other difficulty. [Emphasis added]

117. The passage in *Oram* was approved by Australian authority in *Department of Employment, Education, Training & Youth Affairs v. Duscher.*[81]

118. The Commissioner takes the view that the argument in *Oram* that '*an amount* of expenditure' can include non-cash expenditure is more persuasive when considering the single term 'expenditure' that is used in subsection 40-730(1) of the ITAA 1997.

119. Accordingly, it is the Commissioner's view that the farmor has incurred 'expenditure' that is deductible under subsection 40-730(1)[82] of the ITAA 1997. This view is consistent with the Commissioner's view expressed at paragraph 16 of Taxation Ruling IT 2668,[83] that the provision of a non-cash benefit can be a loss or outgoing for the purposes of section 8-1 of the ITAA 1997.

120. The deduction is allowed in the income year in which the expenditure is incurred. In the context of an immediate transfer farm-out arrangement, this is generally the income year in which the immediate transfer farm-out agreement is executed. This is on the basis that the farmor has an obligation to transfer the interest in the mining tenement at that time. However, in the case where the agreement to acquire an interest in the mining tenement is conditional upon obtaining approval or satisfaction of some condition, this is the income year in which the approval is obtained or the condition is satisfied.

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[80] (1980) 2 All ER 1, at [5].
[81] (1996) 24 AAR 239, at [48].
[82] This is if all 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.
[83] Income Tax – Barter and countertrade transactions.

121. The amount of the expenditure is the market value of the interest in the mining tenement at the time of entry into the farm-out agreement to the extent that it secures the farmor's right to the exploration benefit. To the extent that the transfer of the interest in the mining tenement secures cash payments (whether to, or on behalf of the farmor) or other benefits for the farmor, the market value of the mining tenement is not deductible under subsection 40-730(1) of the ITAA 1997 for the farmor.

122. If a farm-out agreement incorporates a 'free-carry' by the farmee of the farmor's retained interest in the mining tenement, the farmor incurs expenditure that is deductible under subsection 40-730(1)[84] of the ITAA 1997 to the extent that the joint venture operator incurs the farmor's share of expenditure on exploration or prospecting. This occurs in the income year in which the joint venture operator incurs the expenditure.

When the farmee begins to hold its interest

123. 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 agreement is executed if at that time the farmee:

- exercises, or has a right to exercise immediately, the rights in relation to the interest in the mining tenement; and
- has a right to become the legal owner of the interest in the mining tenement and there is a reasonable expectation that legal ownership will transfer to the farmee.

124. 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 through expending funds from the joint venture account contributed to by the farmee; or
  - becomes the joint venture operator thus acting on its own behalf as well as on behalf of other participants;

[84] This is if all 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.

- whether the farmee has a right to become the legal owner of the interest in the mining tenement;
- whether there are circumstances that would indicate that the farmee does not have a reasonable expectation of becoming the legal owner of the interest.

125. In relation to the first consideration, if the agreement provides that activities on the mining tenement cannot occur until the requisite approvals under any applicable legislation have been obtained, then the farmee cannot exercise, or have a right to exercise immediately, the subject matter of the interest in the mining tenement until those approvals have been obtained.

126. In relation to the second consideration, legislation may preclude a farmee from having a right to become the legal owner of the interest in the mining tenement until requisite approvals are obtained.

127. However, if the completion of the agreement is conditional upon obtaining Ministerial approval to change title to the interest in the mining tenement, this does not of itself 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 agreement is executed. Subject to the considerations at paragraph 124 of this Ruling, it would otherwise normally be expected that the agreement is entered into on the basis that the farmee is given a right to become the legal owner of the interest in the mining tenement and would have a reasonable expectation of becoming the legal owner.

128. When the farmee becomes the legal owner of the interest in the mining tenement, the farmee begins to hold the interest in the mining tenement under item 10 of the table in section 40-40 of the ITAA 1997.

Application of sections 6-5, 15-2 and 15-40 of the ITAA 1997

Farmor sharing mining information for identified consideration

129. If the parties have identified any consideration provided by the farmee as being for mining information shared[85] 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.

130. 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

[85] That is, the farmor continues to hold that information.

- 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.

131. Section 15-40 of the ITAA 1997 provides that a taxpayer's assessable income includes any amount[86] received for providing mining information to another entity if:

- the taxpayer continues to hold the information for UCA purposes;[87] and
- the amount is not assessable as ordinary income under section 6-5 of the ITAA 1997.

Farmee's reward for providing the exploration benefit

132. Reward for the provision of a non-cash benefit can be assessable as ordinary income under section 6-5 or statutory income under section 15-2 of the ITAA 1997. This 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.[88]

133. As the consideration received by the farmee (that is, the interest in the mining tenement from the farmor) is reward for the provision by the farmee of the exploration benefit, it is assessable income of the farmee under section 6-5 or 15-2 of the ITAA 1997. That is, the provision of the exploration benefit is treated in the nature of a service by the farmee on revenue account.

134. It is assessable income in an income year to the extent that it has been earned in that income year by the provision of the exploration benefit to the farmor. That is, it is assessable as it is earned in those income years according to the principle enunciated in *Arthur Murray (NSW) Pty Ltd v. FC of T*[89] As an example, it may be reasonable for the farmee to recognise so much of the value of the interest in the mining tenement (net of any cash payments made by the farmee for that interest) in an income year as is proportionate to the percentage of the exploration spend in that income year.

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[86] An amount can include the value of a non-cash benefit (see sections 21 and 21A of the ITAA 1936).
[87] See section 40-40 of the ITAA 1997.
[88] 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.
[89] (1965) 114 CLR 314; 9 AITR 673; 14 ATD 98.

Appendix 2 – Detailed contents list

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MT 2011/D1

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Subject references:

- 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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