TR 2019/4EC - Compendium

Public advice and guidance compendium – TR 2019/4

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2017/D11 *Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data*. It has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

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1	The example at paragraph 20 of the draft Ruling does not accurately describe the following 'typical' industry activities and norms: • The reference to payments by instalment and the inference of a 25–year revenue stream is not correct; under the majority of data license contracts, data licensing fees are fully payable upfront on delivery of the licensed products to the licensee. Deferred payment arrangements may be entered into in very limited cases. • When a data license contract is entered into prior to the completion of the survey acquisition and data processing, it is common for committed license fees to be payable in instalments during this period, with the final instalment typically payable upon delivery of the data. • License fees are not typically time based (for example, annual instalments). • Under some contracts, additional payments (in addition to committed license fees) are contingent upon subsequent events, for example, licensee obtaining title to an exploration permit in the area of the survey, or the drilling of an exploration well.	Paragraphs 3 to 9 of the final Ruling have been revised to more precisely describe the arrangements within its scope. The final Ruling caters for variations in payment arrangements (whether committed or contingent) across different contract types that have been highlighted by the comments raised. The final Ruling also contemplates licence agreements with different terms and does not assume a 25-year revenue stream.
2	The final Ruling should only apply prospectively from its issue date in	We understand the ATO view expressed in the final Ruling on the

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	accordance with Law Administration Practice Statement PS LA 2011/27 *Determining whether the ATO's views of the law should be applied prospectively only*. • Industry participants have long taken (and retain) the view that expenditure incurred on obtaining multi-client information is on revenue account and immediately deductible. To the extent the ATO held it was on capital account, the industry has historically claimed a deduction under other provisions, such as the trading stock provisions, relying on the principles in paragraph 7 of Taxation Ruling TR 93/12 *Income tax: computer software*. • The tax law amendments which introduced a statutory life of 15 years for the effective life of mining, quarrying or prospecting information (MQPI) created by a taxpayer that does not otherwise relate to a specific mine or field (or proposed mine or field) were not intended to apply to the multi-client industry. • Despite the tax law amendments applying to any MQPI held on or after 7:30pm AEST on 14 May 2013, the ATO has not released any guidance in over more than four years in relation to the application of these provisions to the multi-client industry. • Deductibility of exploration expenditure in the oil and gas industry has been a key focus area of the ATO for many years and the ATO has previously published ATO ID 2011/25 *Capital allowances: immediately deductible expenditure - contractor providing geophysical surveying services to entities in the mining and mineral exploration industries* in relation to	application of section 40-80 of the *Income Tax Assessment Act 1997*[1] will not generally result in a less favourable outcome than what has been expressed as the common industry approach of claiming these deductions under section 8-1. In most instances we would expect the practical outcome will be same. If taxpayers are uncertain about their position, we recommend they speak to their advisers or contact us directly to discuss these concerns based on their particular circumstances. Based on general principles, the final Ruling section dealing with the statutory effective life of 15 years for MQPI will not apply before 7.30pm AEST on 14 May 2013 – see paragraph 28 of the final Ruling. We have considered the question of whether the final Ruling should only apply on a prospective basis in line with the principles set out in PS LA 2011/27. We have weighed the relevant factors and do not agree the ATO view of the law should only be applied prospectively. • It has been raised that industry participants believe the expenditure is deductible under section 8-1 or the trading stock provisions. We do not consider it has facilitated or contributed to the development of a potential industry practice regarding deducting the expenditure in this way. • We have not issued any view indicating that the costs in question are immediately deductible (whether by way of guidance or other publication/communication forms such as presentations, seminar papers, web material). • No private rulings have issued that advise these costs are immediately deductible.

[1] All legislative references in this Compendium are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

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	geophysical service contracts. However, no further ATO guidance has been issued in respect to the multi-client industry until now, with the proposed view at significant odds with general industry practice and commercial reality.	• We have not established a general administrative practice of accepting these costs as immediately deductible. The absence of audits is not determinative. To the extent risk reviews were done in prior years, these reviews merely provide an indicative risk rating, without committing or conveying an ATO view that the treatment adopted by taxpayers is correct. • It is unreasonable for taxpayers to rely on TR 93/12 as it was a ruling clearly directed at 'computer software'. It is clear that the seismic data surveyors do not, under multi-client licensing arrangements, dispose of the source code (the master or original copy) of their seismic data to their customers (nor the underlying raw data and intermediate products); they retain all proprietary rights in the survey data. This is to be distinguished from the making of copies of the data to licence to customers.
3	Expenditure incurred in acquiring and processing seismic data is revenue, not capital, in nature. • The costs of obtaining data are a recurring expense, as the sustainability of the multi-client business is dependent upon an evolving data library whereby data is constantly acquired, processed, reprocessed and licensed. They are part of the ordinary operating expenses which allow multi-client seismic Data Providers to exist, and do not add to or change the structure of the business. • The commercial purpose of incurring expenditure is to generate immediate revenue returns through marketing and licensing of the information. • There is no enduring benefit to the Data Providers. A licensing arrangement involves, in substance, a sale of the information with restrictions, under which a company acquires the	We have considered feedback regarding the practical substance of licensing arrangements, and accept that expenditure incurred in acquiring and processing seismic data may be recurrent in nature, and revenue from licensing arrangements may be front-loaded. However, the totality of the circumstances indicate that the relevant expenditure is incurred to create an asset from which an enduring benefit is derived, as explained in paragraphs 30 to 37 of the final Ruling. A Data Provider relies on a library of accumulated seismic data that it seeks to exploit on an ongoing basis. Data acquired from each survey has intrinsic, accretive and synergistic ongoing value because it is continually reviewed, reinterpreted, augmented with additional information or insights from other sources, and used to plan future acquisitions, resurveys or reprocessing of surveys. A Data Provider applies in-house geological and geophysical expertise to interpret, compare and analyse the data, creating unique

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	information but cannot on-sell or otherwise deal with it. • Data licensing generates upfront revenue (primarily in the first 2-3 years after expenditure is incurred), with subsequent revenue being highly contingent. While contractual terms provide for an extended period of restriction, the economic reality is that the data has negligible value after a much shorter period. • Multi-client surveys may be undertaken over the same area by competitors at different times using different technologies. Data Providers therefore cannot maintain exclusivity over information obtained. • The value of data greatly diminishes once clients have licensed copies, as it has little further immediate use. • Concluding that practically all of a Data Provider's expenditure is of a capital nature, where most or all of its assessable income is derived in the near term, would result in a significant mismatch between the timing of recognition of income and deductions.	intellectual property which it can leverage with clients and against competitors when competing for business, current and future. This competitive advantage is preserved by maintaining confidentiality over and controlling use of data for an extended time period. There is no general principle in taxation law matching the timing of recognition of income with that of any deductions.
4	If the ATO maintains its views that the legal form of the data licence arrangements represents the core business model of the Data Provider, then the Data Provider must be held to be trading in data licences and the trading stock provisions must apply to the costs to obtain data that is licenced. The nature of a Data Provider is relevantly similar to that of certain software licence providers, whereby the rights acquired by the user for the program under the licence are limited to those necessary to enable the user to operate the program. Paragraph 7 of TR 93/12 makes no reference to the developer needing to buy, resell, distribute or sub-licence its licences in order for the licences to be	We do not consider that the arrangements considered by TR 93/12 are sufficiently analogous to Data Providers. Paragraph 49 of TR 93/12 distinguishes the situation where ownership of software remains with the developer and does not pass to the distributor or end-user, as is the case where the software is developed for licence rather than sale. Paragraph 50 of TR 93/12 relies on *Commissioner of Taxation (Cth) v Suttons Motors (Chullora) Wholesale Pty Ltd* [1985] HCA 44 (*Sutton Motors*) in asserting that software licences acquired by a taxpayer that is in the business of marketing such licences, 'which is frequently the case with software distributors', should be regarded as

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	treated as trading stock. It clearly states that if software is developed for licence and the developer carries on a business of trading in such licences, then the licences are trading stock.	trading stock for income tax purposes. The basis of that assertion was the High Court's finding that trading stock need not be owned by the taxpayer provided that it is legitimately in the taxpayer's possession as part of the stock to be sold or exchanged in the course of trade. Paragraph 50 goes on to say that '[s]oftware held for the purpose of licensing or sub-licensing would not constitute trading stock if the taxpayer is not in the business of marketing software licences.' In the case of the Data Provider, there is no equivalent of the car wholesaler or software distributor that is an intermediary between the initial owner of the goods and the end-users. The Data Provider creates the data (it does not acquire a licence for data from someone else) and then licenses the data directly to its customers. It does not buy, sell, resell, distribute or sub-licence licences, so as to be carrying on a business of trading in seismic data licences. Further, as we pointed out at the end of paragraph 81 of the draft Ruling, ownership in the seismic data does not pass, whereas in *Suttons Motors*, ownership of the cars did pass.
5	Table item 8 in section 40-40 applies to a Data Provider on the basis that the multi-client company carries on a business of exploration or prospecting for minerals obtainable by such operations, as required by subparagraph 40-80(1)(c)(iii).	Agree. Paragraph 46 of the final Ruling has been revised.
6	Data Providers may cease to hold data at an earlier time to when the data becomes generally available. A balancing adjustment may occur at that earlier time where the asset ceases to be used for any purpose or it is expected never to be used again.	Agree. Paragraphs 18 and 63 to 68 of the final Ruling contemplate that a balancing adjustment may occur at an earlier time to when data becomes generally available.
7	The Data Provider undertakes processing of the information in its own right (that is, before delivering any data products to any of its clients) for the purposes of determining direct hydrocarbon indicators	Agree. Paragraph 14 of the final Ruling has been revised. It is accepted that it will be a question of fact in each case whether a Data Provider first uses seismic data from a survey for its internal

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	and planning further geophysical surveys of its own either in the same area, or in nearby areas. The Data Provider therefore first uses the MPQI for exploration in its own right and satisfies the requirements of subsection 40-80(1)(a).	purposes (before completing the geophysical processing and imaging phase, prior to licensing the data to customers. Where this happens, this will affect the start time of the data as defined in section 40-60. It is accepted that paragraph 40-80(1)(a) can be satisfied where the Data Provider first uses the seismic data by analysing it to inform further exploration.
8	Subparagraph 40-80(1)(c)(iii) is met by the Data Provider on the basis that it carries on a business that includes 'exploration or prospecting' as that term is defined for petroleum which is obtainable by mining operations (of others). This is because: • a Data Provider carries on a business that includes conducting geophysical surveys for petroleum on its own account (not as subcontractor for another party) • geophysical surveys fall within the definition of 'exploration or prospecting' (paragraphs 35 and 37 of Taxation Ruling TR 2017/1 *Income tax: deductions for mining and petroleum exploration expenditure* (quoted in support) • there is no requirement that the entity conducting the exploration business is the same entity that undertakes (or is able to undertake) mining or prospecting operations to exploit the resource in its own right. Subparagraph 40-80(1)(c)(iii) expands the requirements of subparagraphs 40-80(1)(c)(i) and (ii) to extend to companies that conduct exploration activities but not mining operations or proposed mining operations in their own right • there is no requirement that an explorer hold (or seek to hold) a petroleum licence • the ATO should have specific regard to the definition of	Agree. Paragraphs 14 and 55 of the final Ruling have been revised. It is accepted that the business undertaken by a Data Provider will constitute a business of the nature contemplated in subparagraph 40-80(1)(c)(iii).

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	'explore for petroleum' in subsections 19(1) and 230(1) of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* • from a policy perspective, Data Providers that hold a Special Prospecting Authority should be entitled to equal treatment in claiming deductibility for exploration expenditure as afforded to - junior explorers (having regard to ATO ID 2011/25) - exploration and prospecting companies that acquire mining information over an area before obtaining a title - multi-client seismic companies that are members of a consolidated group that carries on mining operations - exploration and prospecting companies that acquire mining tenements and information under a deferred farm-in agreement before title has been transferred (refer Miscellaneous Taxation Ruling MT 2012/2 *Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements*)**.**	
9	There is nothing in the wording of section 40-80 or its accompanying explanatory material that requires consideration of the economic risk of the company undertaking exploration activities. The attempt to import the requirement of 'risk' introduces the question of how much risk is enough and introduces untenable and unnecessary interpretive problems. The provision does not distinguish the activities done for one's own benefit or account *viz* on behalf of others, because it does not contain an 'at risk' requirement. A business that consists of, or includes, activities falling within the definition, satisfies the test in subparagraph 40-80(1)(c)(iii) regardless of how the business is funded, which risks it bears and what contracts it has with others.	Agree. The final Ruling has been revised.
10	References to levels of pre-funding in the range of 70-100% of	We do not consider pre-funding to be a critical factor in

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	project costs advised to the ATO in an earlier round of consultation took into account committed revenues arising from new data licensing contracts entered into during the work-in-progress period. This is not representative of the level of pre-funding or pre-commitment at the time of making the investment decision.	characterising the nature of the Data Provider's business. Accordingly, this point has been omitted from the final Ruling.
11	For the reasons outlined in respect of section 40-80, the requirements of section 40-730 would equally be met. For example, section 40-730 remains relevant for those activities as part of the prospectivity review that do not form part of the cost of a depreciating asset (to the extent they are capital in nature).	The observations about paragraph 40-80(1)(c) are also applicable in the context of section 40-730. However, we consider the expenditure will form part of the cost of a depreciating asset and is excluded from a deduction under section 40-730.
12	The Data Provider first uses the raw data as part of the geophysical processing and imaging process for the purposes of determining the existence of direct hydrocarbon indicators. The use of the data by the Data Provider is not defined by the existence of licencing arrangements.	We have taken this comment on board at paragraph 14 of the final Ruling.
13	A balancing adjustment event should occur in the year that there is no further use of that survey data either from internal prospectivity reviews or via forecast of new licensing commitments. The balancing adjustment should be allowed regardless of whether there are existing licences in place. The Data Provider's use of the data is not dependent on existing licensing arrangements. Only the exploration and prospecting company could be considered to continue to use the data under terms of the licence.	We agree that the use of the seismic data component may not necessarily be confined to licensing it to the Data Provider's customers (see Issue 12 of this Compendium). Therefore the point at which the Data Provider stops using it for licensing may or may not be the point at which the Data Provider stops using it for any purpose. There may be certain limited circumstances in which the Data Provider stops using the data component **for licensing** prior to the expiry of the licence period and has mere ownership of the data (which, without more, may not be sufficient to constitute use of the data). We have been advised that a Data Provider continually uses the data (in the sense of reviewing, revisiting and interpreting or reinterpreting it, as well as recalibrating existing information with new pieces of information or knowledge) to determine new prospective target survey areas, new opportunities to reprocess an earlier survey

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		or to resurvey an area, to engage in knowledge sharing with existing and potential customers about the prospectivity of a certain area and to entice them to drill in a surveyed area to confirm the presence of hydrocarbon and thereby validate the survey results – these are all capable of demonstrating that the data's use by the Data Provider has not ceased. We have revised paragraphs 63 to 68 of the final Ruling to further clarify these points.
14	A more appropriate example would be to consider the reprocessing rather than the resurvey of data. Although resurveying an area may occur in some circumstances, this is relatively uncommon and a more appropriate example would be the reprocessing of data which is undertaken more frequently than resurveying.	We have retained the material on resurveys (paragraphs 74 and 75 of the final Ruling) and have added material dealing with the treatment for Division 40 purposes of reprocessed data (paragraphs 72 and 73 of the final Ruling).