

MT 2004/1 - Petroleum resource rent tax: effects of transferring an interest in an exploration permit or retention lease

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Miscellaneous Taxation Ruling

Petroleum resource rent tax: effects of transferring an interest in an exploration permit or retention lease

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Preamble

*This document does not rule on the application of a 'tax law' (as defined) and is, therefore, not a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. **Taxation Rulings TR 92/1 and TR 97/16** together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Ruling is about

Class of person/arrangement

1. The *Petroleum Resource Rent Tax Assessment Act 1987* (the Act) levies tax on profits made by participants in a petroleum project. Where entitlements to assessable receipts in relation to a petroleum project are transferred, the new participants are subject to the provisions of the Act. The effects of transactions involving the transfer of entitlements to assessable receipts are contained in Division 5 of Part V of the Act.

2. Sections 48 and 48A, which are a part of Division 5, are designed to place the purchaser of an entitlement to assessable receipts in relation to a petroleum project in the same position as the vendor.

3. A question has arisen whether sections 48 and 48A of the Act apply where a vendor transfers all or a part of an interest in:

- an exploration permit or retention lease; or
- in any other entitlement,

at any time when an eligible production licence is not in force.

4. This Ruling considers that question and also examines the consequences that flow to the purchaser and vendor as a result of such a transfer, including the types of expenditure to be transferred.

Ruling

5. Sections 48 and 48A of the Act apply to a transaction that has the effect of transferring an entitlement of a vendor to derive assessable receipts in relation to a petroleum project whether or not an eligible production licence is then in force and whether or not an eligible production licence ever comes into force in relation to the project. So the sections apply when there is only the transfer of an interest in an exploration permit or retention lease or in any other entitlement at any time when an eligible production licence is not in force.

6. Under sections 48 and 48A, the purchaser is taken, in proportion to the interest acquired, to have incurred any expenditure and derived any assessable receipts which would have been expenditure or assessable receipts of the vendor. In addition, the purchaser is taken to have incurred any liability of the vendor and to have paid any amounts paid by the vendor, in respect of instalments of tax during any part of the financial year in which the transaction is entered into before the transfer time.

7. The vendor of such an interest is taken not to have incurred, derived or paid that expenditure, those assessable receipts or that liability which the purchaser is taken to have incurred, derived or paid.

Date of effect

8. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanation

Background

9. Under sections 48 and 48A of the Act, a purchaser takes over expenditure incurred by a vendor in a petroleum project in proportion to the share of the vendor's *assessable receipts in relation to a petroleum project* transferred in effect to the purchaser. Where a transfer of an interest in a petroleum project has the effect of transferring any part of the vendor's entitlement to assessable receipts, the corresponding transfer of expenditure is mandatory.

10. Section 48 applies where the transaction has the effect of transferring the *whole* of the entitlement of the vendor to derive *assessable receipts in relation to a petroleum project*. Section 48A applies where the transaction has the effect of transferring *part only* of the entitlement of the vendor to derive *assessable receipts in relation to a petroleum project*.

11. Sections 48 and 48A are designed to place the purchaser in the same position as the vendor would have been in relation to the petroleum project, but for the transfer (subject to other limitations in the Act). The sections reflect government policy that expenditure is only deductible against the petroleum project in relation to which it is incurred.

Exploration permits and retention leases

12. This Ruling is concerned with transfers of interests in receipts from areas, covered by exploration permits and retention leases or by any other arrangement, at any time when an eligible production licence is not in force and whether such transfers have the effect of transferring a person's entitlements to *assessable receipts in relation to a petroleum project*.

13. The term 'petroleum project' is defined in section 2 as meaning a petroleum project within the meaning of subsection 19(1) or (2). Under subsection 19(1), where an eligible production licence is in force and is not specified in a project combination certificate, a petroleum project is taken to exist in relation to the eligible production licence. While under subsection 19(2), where eligible production licences are specified in a project combination certificate there shall be taken to be a single petroleum project in relation to all those licences.

14. As a petroleum project cannot exist without an eligible production licence there is a view that sections 48 and 48A cannot operate at the time there is a change of interests in an exploration permit, retention lease or under any other arrangement, because at that stage there is no eligible production licence in force. On one view, this means that no change of interests in receipts from an area not covered by a production licence at the time of the change (but covered, say, by an exploration permit or retention lease) can ever have the effect that the purchaser takes over the vendor's expenditure. On another view, this means that the purchaser takes over the vendor's expenditure only if a production licence is later granted for an area derived from that of the exploration permit or retention lease.

15. The Commissioner does not agree with either view. It is our view that the phrase *assessable receipts in relation to a petroleum project* has a broad meaning. The meaning is wide enough to include as assessable receipts amounts received in relation to a petroleum title that is an exploration permit or retention lease. This is consistent with the object and purpose of the Act.

16. The Commissioner's view is supported by the meaning of assessable receipts for petroleum resource rent tax purposes, by the definition of a year of tax and by express subsections of sections 48 and 48A. Subsection 23(1) specifies the meaning, for the purposes of the Act, of *assessable receipts in relation to a petroleum project*. *Assessable receipts in relation to a petroleum project* include the following capital or revenue receipts:

- (a) assessable petroleum receipts;
- (b) assessable exploration recovery receipts;
- (c) assessable property receipts;
- (d) assessable miscellaneous compensation receipts; and
- (e) assessable employee amenities receipts.

17. Section 25 defines 'assessable exploration recovery receipts' and it operates to determine assessable receipts in respect of petroleum, petroleum constituents or marketable petroleum commodities recovered or produced from within an eligible exploration or recovery area (other than from a production licence area). The Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987 states, in respect to section 25, that:

It will apply, for example, to petroleum recovered while drilling, for exploration purposes, in an exploration permit area from which a production licence is later drawn.

18. Similarly, assessable property receipts under section 27, assessable miscellaneous compensation receipts under section 28 and assessable employee amenities receipts under section 29 each include receipts during or in relation to expenditure carried out under an exploration permit or retention lease. So the law is explicit: many kinds of assessable receipts may be derived when no production licence has issued.

19. Support for this view is assisted by sections 31 and 45, which detail that assessable receipts can be derived, and expenditure can be incurred, before a project commences. As such, the reference to the phrase '*in relation to a petroleum project*' in section 48 and 48A contemplates the application of those sections prior to the existence of a petroleum project. The Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1993, introducing subsection 48A(3), confirms this view; it states:

Such a transaction may be entered into where there is not yet a production licence (and hence a project) in existence on an area, but only an exploration permit or retention lease. Assessable receipts may be derived and deductible expenditure incurred in relation to a petroleum project that has not yet started [sections 31 and 45], so a person may have an entitlement to assessable receipts from the project at that time, and may transfer either a part of that entitlement, or that entire entitlement, to another person.

20. The combined effect of sections 23 and 25 is that the phrase *assessable receipts in relation to a petroleum project* includes assessable receipts that may arise in relation to the sale of petroleum etc., recovered from an exploration area. It also includes assessable receipts that may arise in relation to the sale of petroleum etc., recovered from an area held under a retention lease.

21. A reference to the phrase *assessable receipts in relation to a petroleum project* includes assessable receipts that arise from the sale of petroleum etc., recovered from an area held under an exploration permit or retention lease. It follows that a transaction involving the transfer of an interest in receipts from an area held under an exploration permit or retention lease is one that has the effect of transferring the whole or part of the entitlements of the vendor to derive, after the transfer, *assessable receipts in relation to a petroleum project*. This is so even if there is no petroleum project because there is no production licence, and even if there never is a production licence in relation to the area. Accordingly, sections 48 and 48A apply to the transfer of an interest in an exploration permit or retention lease.

22. This conclusion is also supported, as a matter of construction, by the fact that in transferring entitlements to future receipts from an area held under an exploration permit or retention lease one is necessarily transferring entitlements to any receipts from any area that may in future be held under a production licence derived from the exploration permit or retention lease.

23. Further support can be found in the transfer provisions themselves. Subsection 48(1) refers to the time at which a transaction effects the transfer of assessable receipts (that is, the 'transfer time'). It states that the *transfer time* can occur '*...at any time...including a time before the first year of tax of the vendor in relation to the project*'. Subsection 48A(3) is a similar provision. The reference to the term 'year of tax' is to be read in accordance with the definition of that term in section 2, which means '*the first financial year in which assessable petroleum receipts are derived*'. The fact the transfer time can be '*at any time*' even before any assessable petroleum receipts are derived supports the view that the existence of a '*petroleum project*' is not a precondition to the operation of section 48 or 48A. If assessable receipts exceed deductible expenditure before the first year of tax, any petroleum resource rent tax liability is deferred until that first year of tax.

Treatment of expenditure

24. The following commentary is from the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1993, at Chapter 12, Amendment B (clause 12.48 to 12.53 inclusive). The Explanatory Memorandum provides sufficient details that explain the treatment of expenditure under sections 48 and 48A, in introducing section 48A:

When a vendor enters into a transaction which transfers their entire interest in a project, their expenditure is taken to be incurred by the purchaser in two different ways under section 48 of the Act. Deductible expenditure which is not transferable is taken to be incurred by the purchaser in the transfer year, after it has been compounded in the hands of the vendor using either the GDP factor, or the augmented bond rate. This includes 'inherited' expenditure taken to be incurred by vendor as a result of previous section 48 or section 48A transactions.

However, transferable exploration expenditure is treated differently because of the operation of the wider deductibility regime. Transferable exploration expenditure is either class 2 augmented bond rate exploration expenditure, or class 2 GDP factor expenditure. It is calculated under the Schedule and is based on actual exploration expenditure incurred by the person plus any amounts previously taken to have been incurred by the person under section 48. These form the incurred exploration expenditure amount of the person.

A technical result of the calculation of transferable exploration expenditure of the vendor is that some amounts are deemed not to have been incurred by the vendor until they can be utilised. This renders these amounts 'invisible' for the purposes of a section 48 transaction. To avoid this problem, section 48 simply takes the purchaser to have incurred expenditure that would have been included in the incurred exploration expenditure amount of the vendor in relation to the project before the transfer time. The purchaser is taken to have incurred this expenditure at the time the vendor actually incurred it, and the expenditure is compounded in the hands of the purchaser, not the vendor.

A similar approach is taken in section 48A for transactions which transfer part of a person's interest in assessable receipts from a project. The purchaser of a partial interest will be taken to have incurred, in the transfer year, the transfer percentage of deductible expenditure of the vendor which is not transferable, as compounded by the Schedule in the hands of the vendor. As with section 48, deductible expenditure of the vendor in relation to the project includes 'inherited' expenditure of the vendor as a result of previous section 48 or 48A transactions.

In addition, the purchaser of a partial interest will be taken to have incurred the transfer percentage of amounts of expenditure which would have been included in the incurred exploration expenditure amount in relation to the vendor and the project, as if the transfer year had ended immediately before the transfer time.

The purchaser will be taken to have incurred these amounts in the year in which they were actually incurred by the vendor, and they will be compounded under the Schedule to become class 2 augmented bond rate exploration expenditure or class 2 GDP factor exploration expenditure in the hands of the purchaser.

25. It will be important that at the time an interest in assessable receipts from a petroleum project is transferred a purchaser ensures that the expenditure, taken to be incurred under section 48 or 48A, does not include expenditure that was previously transferred to

another project of the vendor prior to the transfer of that interest to the purchaser.

Position of vendor

26. In accordance with paragraph 48(1)(b) and subsection 48A(6), of the Act, the vendor shall be taken not to have incurred, derived or paid, as the case requires, that expenditure, those assessable receipts or that liability which the purchaser is taken to have incurred, derived or paid.

Examples

Example 1

27. Explorer NL is the sole operator on an exploration permit. No petroleum project is yet in existence, and no receipts have been derived, but Explorer NL has incurred \$5 million exploration expenditure.

28. Explorer NL enters into a transaction to transfer half of its entitlement to the future assessable receipts of the project to Buyer. The transfer percentage is 50%.

29. Section 48A of the Act applies to place Buyer in the position in which Explorer NL would have been in relation to the project, in respect of 50% of the \$5 million deductible expenditure incurred by Explorer NL before the transfer time. Buyer is taken to have incurred \$2.5 million exploration expenditure, derived no receipts and paid no tax in relation to the project. Explorer NL will (notionally) carry forward \$2.5 million exploration expenditure.

Example 2

30. Explorer NL is the sole operator on an exploration permit that was granted on 1 July 1998 and no petroleum project is yet in existence. As at 30 June 1999, Explorer NL incurred \$3 million in deductible exploration expenditure and derived \$4 million assessable receipts from the sale of petroleum, which was recovered during its exploration drilling program for testing and analysis purposes.

31. Explorer NL enters into a transaction on 30 June 1999 to transfer all of its entitlement to the future assessable receipts of the project to Buyer.

32. Section 48 of the Act applies to place Buyer in the position in which Explorer NL would have been in relation to the project. Buyer is taken to have incurred \$3 million deductible exploration expenditure and derived \$4 million receipts from the sale of petroleum.

33. As no petroleum project is yet in existence, the \$1 million profit derived by Buyer for the financial year ended 30 June 1999 is not yet subject to tax. The profit is (notionally) carried forward by Buyer and added to any further profit it may derive, or offset against any excess expenditure, in following years. Explorer NL would exit the project without any entitlement to deductible expenditure or assessable receipts.

Detailed contents list

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Commissioner of Taxation

17 November 2004

<i>Previous draft:</i>	<i>Legislative references</i>
MT 2004/D1	<ul style="list-style-type: none"> - PRRTA Act 1987 - PRRTA Act 1987 2
<i>Related Rulings/Determinations:</i>	<ul style="list-style-type: none"> - PRRTA Act 1987 Pt V Div 5 - PRRTA Act 1987 19(1) - PRRTA Act 1987 19(2) - PRRTA Act 1987 23 - PRRTA Act 1987 23(1) - PRRTA Act 1987 25 - PRRTA Act 1987 27 - PRRTA Act 1987 28 - PRRTA Act 1987 29 - PRRTA Act 1987 31
<i>Subject references</i>	
<ul style="list-style-type: none"> - oil companies - oil industry - petroleum - petroleum resource rent tax 	

- PRRTA Act 1987 45
- PRRTA Act 1987 48
- PRRTA Act 1987 48(1)
- PRRTA Act 1987 48(1)(b)
- PRRTA Act 1987 48A
- PRRTA Act 1987 48A(3)
- PRRTA Act 1987 48A(6)
- TAA 1953 Pt IVAAA

Other references

- Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987
- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1993

ATO references

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