



# ***PR 2001/85 - Income tax: Brilliant Gold Reef Project***

 This cover sheet is provided for information only. It does not form part of *PR 2001/85 - Income tax: Brilliant Gold Reef Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *13 June 2001*



# Product Ruling

## Income tax: Brilliant Gold Reef Project

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### Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications sections**), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling parts** of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and 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.*

### No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

### Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

## What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is referred to as 'the Project'.

### Tax laws

2. The tax laws dealt with in this Ruling are:
- section 6-5 of the Income Tax Assessment Act 1997 ('ITAA 1997')
  - section 8-1 (ITAA 1997);
  - section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - Division 35 (ITAA 1997);
  - Division 330 (ITAA 1997)
  - section 82KL of the Income Tax Assessment Act 1936 (ITAA 1936);
  - section 82KZL (ITAA 1936);
  - section 82KZM (ITAA 1936);
  - sections 82KZMA – 82KZMD (ITAA 1936);
  - sections 82KZME – 82KZMF (ITAA 1936);
  - Part IVA (ITAA 1936); and
  - Subdivision 38-L of the *A New Tax System (Goods and Services Tax) Act 1999*.

### Goods and Services Tax

3. In this Ruling, all fees and expenditure referred to include the Goods and Services Tax (GST) where applicable. In order for an entity (referred to in this Ruling as a Gold Explorer) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

**Business Tax Reform**

4. The Government is currently evaluating further changes to the tax system in response to the Ralph Review of Business Taxation and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

**Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

**Class of persons**

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires) and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Gold Explorers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

**Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangements described in the Ruling are materially different from the arrangements that are actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangements entered into are not the arrangements ruled upon; and
- the Ruling will be withdrawn or modified.

10. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## Date of effect

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11. This Ruling applies prospectively from 13 June 2001, the date this Ruling is made. 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).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## **Arrangement**

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14. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for product ruling in relation to ‘the Project’ dated 3 November 2000;
- Replacement Prospectus to be issued by ARG Management Ltd (‘Responsible Entity’), dated 25 May 2001;
- Constitution of the Project, supplied on 28 March 2001;
- Compliance Plan for the Project executed by the directors of the Responsible Entity, supplied on 21 March 2001;
- Operational Management Agreement between the Responsible Entity and Gold Management Pty Ltd (‘GMPL’), supplied on 21 March 2001;
- Supply Services Agreement between Charters Towers Gold Mines Limited (‘CTGM’) and GMPL, supplied on 28 March 2001;
- Joint Venture Agreement between Gold Explorer and the Responsible Entity, being Schedule One of the Constitution of the Project;
- Sub-lease Agreement between CTGM as sub-lessor and Gold Projects Pty Ltd (‘GPPL’) as sub-lessee, supplied 21 March 2001;
- Assignment Agreement between GPPL, Australian Rural Group Ltd (‘Custodian’) and CTGM, supplied 21 March 2001;
- Amendments to above documents supplied on 28 March 2001, 4 April 2001, 12 April 2001, 19 April 2001 and 2 May 2001;
- Constitution of CTGM;
- Constitution of GPPL;
- Constitution of GMPL; and
- Additional correspondence from the Applicant dated 29 March 2001, 2 April 2001, 10 April 2001, 20 April 2001, 23 April 2001, 2 May 2001 and 6 June 2001.

**Note:** certain information received from various entities connected with the Project has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

15. The documents highlighted are those that Gold Explorers enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Gold Explorer, or any associate of a Gold Explorer, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows:

### Overview

16. This arrangement is called the Brilliant Gold Reef Project.

Location	Charters Towers Goldfields in Northern Queensland. The mining tenements chosen for the Project have been specifically defined in the Sub-lease Agreement as being within a granted Mining Lease (ML 10208) and its surrounding Exploration Permits (EPM 8150 and 8563), Mineral Development Licence (MDL 116) and Mining Lease Application (MLA 10251), covering some 3.25km <sup>2</sup>
Type of activity each participant is carrying on	Comprises the carrying on of exploration or prospecting activities for the purpose of engaging in eligible mining operations once a decision to mine has been made.
Area covered by the mining tenement	3.25 square kilometres
Expected production	50,000 oz of gold per annum in year 3 and onwards
The term of the investment	12 years
Initial cost per Participation	\$5,500 (including GST) Exploration Fee
Ongoing costs	Mine operating costs to be funded out of future revenue

17. The arrangement is being conducted as a joint venture to raise \$25,000,000 in order to carry out exploration or prospecting principally for gold deposits on the Charters Towers Goldfield within mineral tenements controlled by GPPL. The exploration or

prospecting phase of the Project is expected to take 2 years and, provided commercial quantities of gold deposits are proven, eligible mining operations will follow for a further 10 years to extract the ore for refining principally into gold bullion for ultimate sale to dealers in precious metals.

18. The Project is an advanced mineral project which will be exploring for precious metal deposits on a known goldfield.

19. Under the various mining tenements controlled by CTGM (which are subject to a sub-lease to GPPL), exploration or prospecting sites have been defined and a drilling program is planned to commence as soon as the minimum subscription of 200 participations is achieved and monies paid to GMPL to undertake the necessary exploration and prospecting activities on behalf of the Joint Venture.

20. The process by which Gold Explorers will enter into the Project and become stakeholders in the arrangement will be effected by way of a Joint Venture Agreement whereby each Gold Explorer, in consideration for the payment of fees pursuant to the Constitution, will become a joint venturer with other Gold Explorers in a joint venture with GPPL.

A summary of the main agreements which govern the Project is provided below.

### **Constitution and Joint Venture Agreement**

21. The Constitution of the Project governs the rights and obligations of each Gold Explorer entering the Project. It serves as a legally binding contract between the Responsible Entity and each Gold Explorer. Further, the Constitution incorporates the Joint Venture Agreement (per Schedule One of the Constitution) between all participating Gold Explorers.

22. Under the Joint Venture Agreement, each Gold Explorer agrees to appoint ARG Management Ltd (ARGM) as the Responsible Entity and to participate in the Project which comprises the carrying on of exploration and prospecting activities for the purpose of engaging in eligible mining operations once a decision to mine has been made. Each Gold Explorer is entitled to a proportional interest in the Joint Venture of .008% for each Participation they take up in the Project. At maximum subscription, Gold Explorers would have a 40% interest in the Project, while GPPL would hold a 60% interest.

### **Compliance Plan**

23. The Responsible Entity has entered into the Compliance Plan in accordance with the Corporations Law and by doing so has agreed

to be bound by the obligations specified in that document for the benefit and protection of the Gold Explorers who invest in the Project.

## **Operational Management Agreement**

24. Under the Joint Venture Agreement, Gold Explorers appoint ARGM as the Responsible Entity to carry out certain duties on their behalf. In order to carry out its obligations to Gold Explorers under the agreement, the Responsible Entity has entered into an Operational Management Agreement with GMPL.

25. Under the Operational Management Agreement the Responsible Entity appoints GMPL as the Operational Manager of the Project. Under the terms of the agreement, GMPL has agreed to undertake to perform certain tasks related to the Responsible Entity's responsibilities to the Gold Explorers as specified under the Joint Venture Agreement. Effectively, by virtue of the various agreements in place, each Gold Explorer has contracted the management function to GMPL, as an independent contractor, to carry on the exploration activities and to carry out all mining activities necessary to produce gold.

26. During the first two years of operation GMPL will perform all the works required to undertake the necessary exploration or prospecting activities, these will include:

- obtaining all necessary Local Council and landowner approvals for disturbing or clearing the land designated for drill pad sites;
- surveying drill collars and boreholes orientation;
- geological mapping, drill core logging and geochemical sampling on the sub-lease, computer data entry, ore body modelling and estimation of Mineral Resources and Ore Reserves;
- identifying and avoiding damage to utilities including telephone, electricity, water and gas;
- building drill pads, roads, tracks and pathways with minimum environmental disturbance;
- building sheds required for storage of drill core and core-cutting machinery and sampling equipment;
- embark on such operations as may be reasonably required to prevent or combat land degradation and environmental damage;

- calling, assessing and letting tenders for reverse circulation and diamond-core drilling and core assaying;
- supervising drilling activities by contract drillers;
- holding public risk insurance to the value of not less than \$10,000,000;
- carry out all other activities necessary to develop and manage the ore body; and
- prepare a rigorous feasibility study.

27. In consideration for these services the Responsible Entity agrees to pay to the Operational Manager the fees as detailed in the Operational Management Agreement.

### **Supply Services Agreement**

28. CTGM and GMPL have entered into a Supply Services Agreement whereby CTGM agrees to provide services and access to the substantial infrastructure set up by CTGM for the mining and processing of gold. The term of the agreement is for 12 years and may be extended if agreed to between the parties.

### **Sub-lease Agreement**

29. The sub-lease agreement between CTGM and GPPL provides GPPL with mining and exploration rights over the sub-lease area of the mining tenements. The agreement sets out rental for the life of the Project and requires that the mining tenements are maintained in good standing.

30. GPPL has registered its interest in the mining tenement via legal caveats over exploration permits, mineral development leases and applications and registered interests in granted mining leases.

### **Assignment Agreement**

31. Under the terms of the Assignment Agreement, GPPL (as founding member being the sub-lessee under the sub-lease from CTGM) agrees to assign to the Custodian the sub-lease under certain terms and conditions and CTGM has consented to such assignment.

### **Fees**

32. Gold Explorers will pay to the Responsible Entity the amounts (expressed as Gold Exploration Fees) as set out in clause 4.1 of the

Constitution. Gold Explorers taking up an interest in the Project will be required to pay \$5,500 (inclusive of GST) for each Participation on execution of the agreement to enter the Project.

33. Regardless of how a Gold Explorer funds the Exploration Fee, each Gold Explorer will become liable to pay the fee on execution of the relevant agreements and a liability to the Responsible Entity will exist from that time. In some instances a Gold Explorer may borrow the requisite funds to acquire an interest and in such cases the borrowed funds will be required to be paid over to the Responsible Entity as soon as possible after loan funds have been approved and released.

34. Under the terms of the Constitution, all moneys received from applications shall be paid to the Custodian. The Custodian shall deposit those moneys into an Application Fund in the name of the Custodian. The application moneys will be released to the Responsible Entity and Operational Manager as provided for in the Constitution and the Operational Management Agreement.

## **On-going Management**

35. From Year 3 onwards, all fees payable under the terms of the Project will be funded out of revenue generated from the sale of gold bullion produced from carrying on eligible mining operations.

## **Finance**

36. Participants can fund their investment in the Project themselves, or borrow from an independent lender.

37. This Ruling does not apply if a Gold Explorer enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;

- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved, in the provision of finance to Members for the Project.

## **Ruling**

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### **Assessable income**

38. A Gold Explorer's share of the gross sale proceeds derived from the sale of gold bullion produced from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5 of the ITAA 1997. Section 17-5 of the ITAA 1997 excludes amounts relating to GST payable on taxable supplies from assessable income.

### **GST Effect**

39. It is envisaged that the Project will only supply gold bullion, of at least 99.5% fineness and in an investment form, to registered dealers in precious metals. On this basis such supplies, if they are the first supplies of the gold bullion after its refining by a refiner of precious metal, may be GST-free as provided for pursuant to Subdivision 38-L of the *A New Tax System (Goods and Services Tax) Act 1999*.

### **Minimum subscription**

40. A Gold Explorer will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached. Under the prospectus, a Gold Explorer's application will not be accepted and the Project will not proceed until the minimum subscription of 200 Participations is achieved. Tax deductions are not allowable until these requirements are met.

**Section 8-1 and section 330-15****Deductions where a Gold Explorer is not registered or not required to be registered for GST**

41. A Gold Explorer may claim the deductions detailed in the following table, where the Gold Explorer:

- participates in the Project by 30 June 2001 and proposes to carry on 'eligible mining operations' (as defined in section 330-30 of the ITAA 1997);
- incurs the fees shown in the table below; and
- is not registered or required to be registered for GST.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 30/6/2001</b>	<b>Year 2 30/6/2002</b>
<b>Exploration fee</b>	330-15	As incurred - see note (i) below	As incurred - see note (i) below
<b>Other fees and interest</b>	8-1	As incurred – see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below

A Gold Explorer may claim the deductions detailed in the following table, where the Gold Explorer:

- participates in the Project by 30 June 2002 and proposes to carry on 'eligible mining operations' (as defined in section 330-30 of the ITAA 1997);
- incurs the fees shown in the table below; and
- is not registered or required to be registered for GST.

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year 1 30/6/2002</b>	<b>Year 2 30/6/2003</b>
<b>Exploration fee</b>	330-15	As incurred - see note (i) below	As incurred - see note (i) below
<b>Other fees and interest</b>	8-1	As incurred - see notes (ii), (iii) & (iv) below	As incurred – see notes (ii), (iii) & (iv) below

**Notes:**

- (i) Upon application, each Gold Explorer will enter into a binding contract with the Responsible Entity for the full cost of entering into the Project, namely, \$5,500. Gold Explorers will only be entitled to a deduction in terms of section 330-15 when the money is correctly paid to the Operational Manager pursuant to the terms of the Operational Management Agreement.
- (ii) Amounts of less than \$1,000 will be 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (see example 2 at paragraph 94). Deductibility of amounts of \$1,000 or more, such as may occur where a Participant acquires a number of interests in the Project will be determined using the formula shown in paragraph 46.
- (iii) Deductibility or otherwise of interest arising from agreements entered into to finance participations in the Project is outside the scope of this Ruling. However, all Participants who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 76 to 80 below, as those rules may be applicable if the interest is prepaid.
- (iv) Where a Participant **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Participant's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraph 79). To apportion the expenditure over the eligible

service period, these provision, which apply respectively to ‘small business taxpayers’ and taxpayers who are not ‘small business taxpayers’, effectively use the same formula as that shown in paragraph 46.

42. Subject to a Gold Explorer entering the Project as outlined in this Ruling:

- (a) A deduction is available in a year of income to Gold Explorers under subdivision 330-A of the ITAA 1997 for expenditure (including expenditure of a capital nature) incurred in conducting ‘exploration or prospecting’ activities as defined in section 330-20 of the ITAA 1997, on the basis that it is reasonable to conclude that each Gold Explorer proposes to carry on eligible mining operations as defined in section 330-30 of the ITAA;
- (b) A deduction is available in a year of income to Gold Explorers under section 8-1 of the ITAA 1997 for interest incurred on borrowed funds used to acquire an interest, or interests, in the Project.

### **Deductions where a Gold Explorer is registered or required to be registered for GST**

43. Where a Gold Explorer who is registered for GST (or required to be registered for GST) invests in the Project and is entitled to an input tax credit, then the amount of the deductions is reduced by the amount of the input tax credit (per Division 27 ITAA 1997). See Example 1 at paragraph 93.

### **Tax avoidance provisions - sections 82KL and Part IVA**

44. For a Gold Explorer who invests in the Project and incurs expenditure in accordance with the Joint Venture Agreement the following provisions of the ITAA 1936 have applications as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

**Prepayment rules****Exploration or prospecting expenditure**

45. Where exploration or prospecting expenditure is not of a revenue nature a deduction is only allowable under section 330-15 and not under section 8-1 of the ITAA 1997. The prepayment rules contained in Subdivision H of Division 3 of Part III of the ITAA 1936 (i.e., sections 82KZL to 82KZO) will not apply as the exploration or prospecting expenditure is deductible under section 330-15 and not section 8-1 of the ITAA 1997 – a requirement of Subdivision H being that the expenditure is otherwise deductible under section 8-1.

**Other fees**

46. In this Project the Joint Venture Agreement that Gold Explorers enter into does not require fees to be paid by Gold Explorers prior to the commencement of each eligible service period. If however, a Gold Explorer chooses to incur expenditure in respect of services to be provided for a period that has not yet commenced then the prepayment will not be deductible in full in the year in which it is incurred. Rather, using the formula shown below, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided (see paragraphs 76 to 80).

$$\text{Expenditure x } \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

**Division 35 – losses from non-commercial business activities**

47. The object of this Division is to prevent losses from non-commercial activities that are carried on as businesses by individuals being offset against other assessable income. This Division is not intended to apply to activities that do not constitute carrying on a business.

48. At the time allowable exploration or prospecting expenditure under ‘test 2’ of subsection 330-15(2), and related interest for Years 1 and 2, allowable under section 8-1, is incurred, a business will not be being carried on. Division 35 will therefore have no application to this expenditure.

49. If a decision to mine is made and the Project proceeds to carry on a mining business then, from Year 3 onwards, the documentation provides that all fees payable under the terms of the Project will be funded out of revenue generated. Given this arrangement then it is

anticipated that there will not be any losses from this business. Therefore Division 35 can have no application in these circumstances.

## Explanations

### Subdivision 330-A - exploration or prospecting expenditure

#### Section 8-1 – general deductions

50. Subdivision 330-A of the ITAA 1997 provides for a deduction for expenditure (whether of a capital nature or not) incurred on exploration or prospecting for minerals, obtainable by eligible mining operations, during that income year.

51. Section 330-15 provides for the deductibility of such exploration or prospecting expenditure. However, to be deductible a taxpayer must satisfy one or more of the tests in subsection 330-15(2).

52. The second test in subsection 330-15(2) for exploration or prospecting for minerals requires that it would be reasonable to conclude that you proposed to carry on eligible mining operations.

53. There are 2 aspects to claiming a deduction under these provisions:

- (1) The Gold Explorer must be the one carrying on the exploration or prospecting activities; and
- (2) The Gold Explorer must propose to carry on eligible mining operations.

#### *Exploration or prospecting activities being carried on by the Gold Explorer*

54. A Gold Explorer's involvement in exploration or prospecting activities must evidence more than the mere payment of a specified sum and the awaiting of an outcome from that investment. The overall tenor of the management agreement and any other agreements/documents relevant to that investment, together with the conduct of the Gold Explorer, must be that the activity is being carried on by the Gold Explorer. In determining whether a Gold Explorer is carrying on exploration or prospecting activities the following criteria are considered relevant:

- whether the Gold Explorer has an interest in an exploration licence and a right to extract and sell the minerals obtained from the tenement;
- whether the Gold Explorer holds an interest in one or more exploration licences or authorities;

- whether the operating agreement recognises that it is the Gold Explorer who incurs contractual obligations for expenditure on exploration or prospecting;
- what is the Gold Explorer's understanding and professed motive for participation in the Project;
- what is the extent of the Gold Explorer's involvement in gold exploration, whether by way of this Project or otherwise;
- what is the degree of involvement and control which the Gold Explorer has in relation to participation in the Project's arrangements, e.g., attendance at meetings of "Gold Explorers" etc.;
- whether the Gold Explorers have control over the manager and can give directions to or dismiss the manager; and
- whether the Gold Explorers are supplied with sufficient information to enable them to make informed decisions commensurate with a person carrying on exploration or prospecting activities. For example, Gold Explorers should have access to geological and other information.

55. A Gold Explorer carrying on exploration or prospecting activities may employ a contractor to carry out the actual work. Usually this would involve the Gold Explorer entering into a management agreement under which a manager purports to carry out the exploration or prospecting activities on the Gold Explorer's behalf. Whether the manager carries out such activities on the Gold Explorer's behalf is determined by an examination of the specific terms of the investment, the manner in which the exploration or prospecting activities are carried out, and the conduct of the Gold Explorer and the manager in relation to that investment. If it can be demonstrated that a Gold Explorer is carrying on exploration or prospecting activities and that the manager is carrying out the activities on the Gold Explorer's behalf, then section 330-595 will allow the deduction to the Gold Explorer as if the Gold Explorer had in fact carried out the work in their own right.

56. For this Project, Gold Explorers have, under the Operational Management Agreement, certain rights over an existing mining tenement consistent with the intention to carry on eligible mining operations. Through this agreement, Gold Explorers appoint the Responsible Entity (who in turn appoints GMPL) to provide services as and when required according to recognised mining practice. The specific cost of these services provided in the year to 30 June 2001 will total \$5,500 (inclusive of GST), as provided for in the expenditure projections contained in the Prospectus.

57. Gold Explorers have the right to use the mining tenement in question for exploration, prospecting and mining purposes and to have the Responsible Entity come onto the mining tenement and to carry out its obligations under the Constitution and the Operational Management Agreement. Under the Project, Gold Explorers are entitled to receive regular progress reports on the Responsible Entity's activities and Gold Explorers will be given every opportunity to visit the mine site and to provide feedback to the Operational Manager as deemed appropriate. Gold Explorers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect. The exploration, prospecting and eligible mining operations described in the Operational Management Agreement are carried out on the Gold Explorer's behalf.

58. Gold Explorers intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Gold Explorers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

59. Gold Explorers will engage the professional services of an operational manager (GMPL) with appropriate credentials. These services are based on accepted mineral exploration and mining practices and are of the type ordinarily found in exploration and mining joint ventures that would commonly be said to be businesses that operate in the real commercial world.

60. Gold Explorers have a continuing interest in the mining tenement for the duration of the Project. Furthermore, this interest begins from the time exploration or prospecting activities begin until the product (i.e., gold bullion) is sold on their behalf. The mining activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them.

61. The degree of control that Gold Explorers have over the Responsible Entity, as evidenced by the agreements and supplemented by the Corporations Law, is sufficient to demonstrate that Gold Explorers have effective control of the Project. Provided each Gold Explorer undertakes sufficient involvement in the Project's exploration or prospecting activities it is reasonable for the Commissioner to conclude that exploration or prospecting activities will be carried on by the Gold Explorers.

*Proposed to carry on eligible mining operations*

62. The second test in subsection 330-15(2) requires that Gold Explorers propose to carry on eligible mining operations. It is

therefore necessary to consider whether a proposal to mine exists and, if this is the case, whether a Gold Explorer can be considered to be carrying on eligible mining operations.

63. For this Project, Gold Explorers have, under the Operational Management Agreement, certain rights over an existing mining tenement consistent with the intention to carry on eligible mining operations. Through this agreement, Gold Explorers appoint the Responsible Entity (who in turn appoints GMPL) to provide services as and when required according to recognised mining practice.

64. The Operational Management Agreement gives Gold Explorers an interest in the ore to be extracted and, once refining takes place, to the gold bullion produced. Gold Explorers have appointed the Responsible Entity to arrange the marketing and sale of the gold bullion on their behalf. For security reasons, Gold Explorers have opted not to process the ore themselves. Rather, this service will be undertaken by the Charters Towers Group and a proper accounting provided to each Gold Explorer as to their respective share of precious metal which is refined and sold on their behalf.

65. Gold Explorers intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Gold Explorers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as an income tax deduction.

66. Gold Explorers have a continuing interest in the mining tenement for the duration of the Project. Furthermore, this interest begins from the time exploration or prospecting activities begin until the product (i.e., gold bullion) is sold on their behalf. The mining activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them.

67. The question as to whether each Gold Explorer will be carrying on eligible mining operations is identical to that discussed in paragraphs 54 to 61 of this Ruling in regard to Gold Explorers carrying on exploration or prospecting activities.

68. It follows, therefore, that each Gold Explorer is proposing to carry on eligible mining operations.

#### *Deductibility of expenditure*

69. Under the terms of the agreements entered into by Gold Explorers upon entering the Project, and provided each Gold Explorer undertakes sufficient involvement in the Exploration or Prospecting activities, Gold Explorers satisfy the criteria necessary to demonstrate

that exploration or prospecting activities are being carried on by the Gold Explorers and that Gold Explorers propose to carry on eligible mining operations.

70. Pursuant to section 330-15, therefore, expenditure incurred on 'exploration or prospecting' activities as defined in section 330-20 of the ITAA 1997 will be deductible to Gold Explorers to the extent of expenditure incurred during a year of income. Such expenditure is not incurred on subscription to the Project. This expenditure will only be incurred for the purposes of subsection 330-15(1) when the money is correctly paid to the Operational Manager pursuant to the terms of the Operational Management Agreement.

71. If a decision to mine is made and the mining activities commence then the Gold Explorers will have commenced eligible mining operations at the time the Mining Operational Costs and Fees are incurred. Deductions for these expenses will generally be deductible under paragraph 8-1(1)(a) as they will have a sufficient connection to the operations by which income is derived. Section 8-1 is however, subject to Division 27 of the ITAA 1997 (*Effect of input tax credits etc on deductions*).

72. As specific details of the expenditure involved with the Mining Operational Costs and Fees have not been supplied it can only be confirmed that they would generally be deductible under section 8-1. To the extent that any of these costs or fees are of a capital nature they will not be deductible unless they fall within the provisions of Subdivision 330-C (*Development and operation of a mine*). Further consideration of such costs or fees is outside the scope of this Product Ruling.

**Prepayments provisions – sections 82KZM, 82KZMA – 82KZMD and 82KZME – 82KZMF**

73. The prepayment provisions of the ITAA 1936 operate to spread over more than one income year, a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement that is not wholly done within the same year of income as the year in which the expenditure is incurred.

74. Under the Joint Venture Agreement the Mining Operational Fee and Mining Operational Costs will become payable once mining operations commence. Such fees may, in some instances, be prepaid for an eligible service period which continues beyond 30 June in a given year of income. In this instance no explicit conclusion can be drawn from the arrangement's description that the relevant fees have

been inflated to result in reduced fees being payable for subsequent years.

75. Should the amount of the fees payable in any given year exceed \$1,000 per Participation, the provisions of sections 82KZM, 82KZMA - 82KZMD, and 82KZME - 82KZMF will need to be considered.

### **Prepaid fees**

76. The amount and timing of deductions for any prepaid fees, otherwise deductible under section 8-1, will depend on when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means generally, the period over which the services are to be provided.

77. Where a Gold Explorer participating in this Project incurs expenditure, otherwise deductible under section 8-1, in respect of the doing of things (e.g., the performance of management services or the lending of money), prior to the commencement of the eligible service period, the prepaid expenditure is not deductible in the year in which it is incurred. Rather, the prepayment provisions of the ITAA 1936 will operate to allow the income tax deduction in the period that the prepaid benefits are provided. The relevant provision of the ITAA 1936 will depend on a number of factors including the amount and timing of the prepayment and whether the Gold Explorer is a 'small business taxpayer'.

78. Where a Gold Explorer participating in this Project incurs expenditure, otherwise deductible under section 8-1, in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

79. Where a Gold Explorer participating in this Project incurs expenditure, otherwise deductible under section 8-1, in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Gold Explorer is a small business taxpayer or section 82KZMD if the Gold Explorer is not a small business taxpayer. For small business taxpayers the

amount and timing of the allowable deductions will then be calculated under the formula in subsection 82KZM(1) and for non-small business taxpayers under the formula in subsection 82KZMD(2). Both formulae are the same, or effectively the same as that shown in paragraph 78 above, concerning section 82KZMF.

80. Prepaid fees of less than \$1,000 in each expenditure year are 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZMA(4) and 82KZME(7) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Gold Explorer acquires more than one Participation in the Project and the quantum of prepaid fees is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

### **Small business taxpayers**

81. Whether a Gold Explorer is a 'small business taxpayer' depends upon the individual circumstances of each Gold Explorer and is beyond the scope of this Product Ruling. It is the individual responsibility of each Gold Explorer to determine whether or not they are within the definition of a 'small business taxpayer'.

82. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

83. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

### **Interest deductibility**

84. The deductibility of interest incurred by Gold Explorers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by the Tax Office.

85. While the terms of any finance agreement entered into between relevant Gold Explorers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME,

‘agreement’ (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

86. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Gold Explorers will be required to determine any tax deduction using the formula in subsection 82KZMF(1), as shown at paragraph 78.

87. Where the ‘eligible service period’ relating to the prepaid amounts ends more than 13 months after the Gold Explorer incurs the expenditure, sections 82KZME and 82KZMF will not apply, as the requirement of paragraph 82KZME(1)(b) is not met. Instead, for a Gold Explorer who is a ‘small business taxpayer’ (see paragraphs 81 to 83) subsection 82KZM(1) applies to apportion the expenditure and determine the amount and timing of the deductions. Alternatively, for a Gold Explorer who is not a ‘small business taxpayer’ subsection 82KZMD(2) applies to apportion the expenditure and determine the amount and timing of the deductions.

88. Both of these provisions, although slightly different in form, apportion deductible expenditure over the ‘eligible service period’ in the same way as the formula contained in paragraph 78 (above).

### **Section 82KL**

89. The operation of section 82KL depends, among other things, on the identification of a certain quantum of ‘additional benefits(s)’. Insufficient ‘additional benefits’ will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 8-1.

### **Part IVA - general tax avoidance provisions**

90. For Part IVA to apply there must be a ‘scheme’ (section 177A), a ‘tax benefit’ (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

91. The Brilliant Gold Reef Project will be a ‘scheme’. A Gold Explorer will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 41 and 42 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

92. Gold Explorers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual sale of gold bullion. There are no facts that would suggest that Gold Explorers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## **Examples**

### **Example 1 – entitlement to 'input tax credit'**

93. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the 'price of the taxable supply' for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$1/11 \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 less \$500).

### **Example 2 – apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'**

94. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year

for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

#### *Management fee*

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

#### *Lease fee*

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\begin{aligned} & \$3,600 \times \frac{365}{365} \\ & = \$3,600 \text{ (this represents the whole of the first year's management} \\ & \text{fee prepaid in the 2001 income year but not deductible until the 2002} \\ & \text{income year).} \end{aligned}$$

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

## **Detailed contents list**

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### **Commissioner of Taxation**

13 June 2001

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<i>Previous draft:</i>	- ITAA 1936 82KZL(1)
Not previously issued in draft form	- ITAA 1936 82KZM
	- ITAA 1936 82KZM(1)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZMA
PR 1999/95; TR 92/1; TR 92/20,	- ITAA 1936 82KZMA(4)
TR 97/16; TD 93/34; TR 98/22;	- ITAA 1936 82KZMB
	- ITAA 1936 82KZMC
	- ITAA 1936 82KZMD
<i>Subject references:</i>	- ITAA 1936 82KZMD(2)
- carrying on a business	- ITAA 1936 82KZME
- commencement of business	- ITAA 1936 82KZME(1)(b)
- gold sales	- ITAA 1936 82KZME(4)
- minerals exploration expenses	- ITAA 1936 82KZME(7)
- mining expenses	- ITAA 1936 82KZMF
- producing assessable income	- ITAA 1936 82KZMF(1)
- product rulings	- ITAA 1936 82KZO
- public rulings	- ITAA 1936 Pt IVA
- schemes and shams	- ITAA 1936 177A
- taxation administration	- ITAA 1936 177C
- tax avoidance	- ITAA 1936 177D
- tax benefits under tax avoidance schemes	- ITAA 1936 177D(b)
- tax shelters	- ITAA 1997 6-5
- tax shelters project	- ITAA 1997 8-1
	- ITAA 1997 8-1(1)(a)
	- ITAA 1997 17-5
<i>Legislative references:</i>	- ITAA 1997 Div 27
- ITAA 1936 82KL	- ITAA 1997 Div 35
- ITAA 1936 82KZL	- ITAA 1997 Div 330
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- ITAA 1997 330-20
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  - ITAA 1997 Subdiv 330-A
  - ITAA 1997 Subdiv 330-C
  - ITAA 1997 330-15
  - ITAA 1997 330-15(1)
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## ATO References

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