TR 2014/9 - Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?

There is a Compendium for this document: **TR 2014/9EC** .

Taxation Ruling

Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?

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What this Ruling is about

1. This Ruling considers the meaning of the phrase '… involved in or in connection with exploration for petroleum …' in paragraph 37(1)(a) of the *Petroleum Resource Rent Tax Assessment Act 1987* (the PRRTAA).

Definitions

2. In this Ruling the following terms and abbreviations are used.

Term/Abbreviation	Meaning
BOD	Basis of design
Domgas	Domestic Gas
FEED	Front End Engineering and Design
FID	Final Investment Decision
Gas-in-place	The total quantity of gas that is estimated to exist originally in naturally occurring reservoirs. (Source- Glossary to the SPE-PRMS guidelines)

Term/Abbreviation	Meaning
GTL	Gas-to-Liquids
ITAA 1997	*Income Tax Assessment Act 1997*
JVPs	Joint venture participants
LNG	Liquefied natural gas
Paragraph 37(1)(a) phrase	The phrase 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA.
Pool	An individual and separate accumulation of petroleum in a reservoir. (Source- Glossary to the SPE-PRMS guidelines)
Petroleum project	A petroleum project as described in Part IV of the PRRTAA.
Production Licence	A production licence as described in section 2 of the PRRTAA.
PRRTAA	*Petroleum Resource Rent Tax Assessment Act 1987*
Pre-FEED	Pre-Front End Engineering and Design
Regret Cost	'Regret cost' can be described as a cost incurred in anticipation of a petroleum project proceeding, where ultimately the project does not proceed. For example, a cost incurred on detailed design work that is undertaken in anticipation of a positive FID, in circumstances where a positive FID does not occur.
Reserves	Reserves are those quantities of petroleum anticipated to be commercially recoverable by application of development projects to known accumulations from a given date forward under defined conditions. Reserves must further satisfy four criteria: They must be discovered, recoverable, commercial, and remaining (as of a given date) based on the development project(s) applied. (Source- Glossary to the SPE-PRMS guidelines)

Term/Abbreviation	Meaning
Reservoir	A subsurface rock formation containing an individual and separate natural accumulation of moveable petroleum that is confined by impermeable rocks/formations and is characterized by a single-pressure system. (Source- Glossary to the SPE-PRMS guidelines)
RL	Retention Lease as described in section 2 of the PRRTAA.
SPE-PRMS	Society of Petroleum Engineers, World Petroleum Council, American Association of Petroleum Geologists, Society of Petroleum Evaluation Engineers – Petroleum Resources Management System.

Ruling

'Exploration for petroleum' – takes its ordinary meaning

3. In section 37 of the PRRTAA, the words 'exploration for petroleum' bear their ordinary meaning.

4. That ordinary meaning is limited to the discovery and identification of the existence, extent and nature of petroleum.[1] This includes searching in order to discover the resource, as well as the process of ascertaining the size of the discovery and appraising its physical characteristics.

5. Appraisal of the physical extent and nature of a find may be a considerable exercise and can involve recovery of some of the resource in the course of exploration – for example, drilling an appraisal well and extracting a sample of the resource for testing.

'Involved in or in connection with' – does not extend the ordinary meaning of 'exploration for petroleum'

6. The phrase 'involved in or in connection with' does not extend the ordinary meaning of 'exploration for petroleum'.

[1] Petroleum as defined in section 2 of the PRRTAA.

'In connection with' – covers operations and facilities that can be shown to have a reasonably direct relationship with 'exploration for petroleum'

7. The words 'in connection with' extend the operations and facilities for which a relevant deduction could be claimed beyond those which are directly involved in exploration. These words ensure the inclusion of all operations and facilities which exhibit a reasonably direct relationship with exploration for petroleum (for example, with the activities of searching for, and identifying, petroleum). Remote and indirect connections are not sufficient. For example, contract negotiations for the sale of the resource would not have the necessary connection with exploration.

'Involved in or in connection with exploration for petroleum' does not include operations and facilities carried on or provided to evaluate the discovery, such as whether it is economically feasible to develop or how best to develop it

8. Once petroleum is discovered, operations and facilities carried on or provided to evaluate the discovery[2] (non-exploration evaluation activities) are not 'involved in or in connection with exploration for petroleum'. For example, operations and facilities carried on or provided to determine whether it is economically (including technically) feasible or commercially viable to proceed to development, or how best to develop a known petroleum pool are not involved in or in connection with the discovery and identification of the existence, extent and nature of petroleum.

9. Carrying on or providing the operations and facilities involved in such feasibility studies may fall within paragraph 38(1)(a) of the PRRTAA, which specifically refers to *any* feasibility or environmental study in the context of operations and facilities preparatory to the recovery of petroleum and other specified activities.[3] Expenditure incurred on[4] operations and facilities covered by section 38 can receive recognition as general project expenditure once there is a petroleum project in relation to a production licence (that is in force).[5]

10. Whilst subsection 38(1) of the PRRTAA contains an exclusion for exploration expenditure, that exclusion only has a narrow potential for operation in relation to feasibility studies. Feasibility studies will in most cases be covered by paragraph 38(1)(a) and not section 37 of the PRRTAA.

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[2] The phrase 'evaluate the discovery' in this context is not intended to cover evaluation activities that are within the ordinary meaning of exploration or 'in connection with exploration for petroleum'. This is the case notwithstanding that such activities could in some cases be broadly described as an evaluation of the discovery (for example, the appraisal of the extent and nature of a find).

[3] The relevant activities are covered in subsection 19(4) of the PRRTAA.

[4] In this Ruling, 'incurred' is used in the context of how that term is understood in sections 37 and 38 of the PRRTAA.

[5] See section 19 of the PRRTAA for the meaning of petroleum project. See section 2 of the PRRTAA for the definition of a 'production licence'.

11. Feasibility and environmental studies and other preparatory activities, however, may be 'in connection with exploration for petroleum' and therefore fall within paragraph 37(1)(a) of the PRRTAA where there is shown to be a reasonably direct relationship between those studies and activities and 'exploration for petroleum'. That is, where they are in connection with the discovery and identification of the existence, extent and nature of petroleum (exploration).

12. For example, feasibility studies that address whether or not to continue exploring for a resource may be 'in connection with exploration for petroleum' in the context of paragraph 37(1)(a) of the PRRTAA. If so, the expenditure incurred on such studies would be covered by the exclusion in subsection 38(1) of the PRRTAA to the extent that such expenditure would otherwise be general project expenditure (preparatory to recovery of petroleum and other specified activities).

13. Section 37 of the PRRTAA and subsection 40-730(4) of the *Income Tax Assessment Act 1997* (ITAA 1997) deal with exploration in different ways, and the scope of the income tax provision does not govern the interpretation of section 37 of the PRRTAA. For example, post-discovery economic feasibility studies of the kind described in paragraph 40-730(4)(c) of the ITAA 1997 would not fall within the scope of paragraph 37(1)(a) of the PRRTAA. They would not have a reasonably direct relationship with exploration for petroleum to be considered to be 'in connection with exploration for petroleum'.

Other matters

14. The decision to produce, a final investment decision (FID), 'phases' of activities or similar things do not provide a dividing line between what may fall within section 37 of the PRRTAA and what may fall within section 38 of the PRRTAA.

15. Similarly, regulatory regimes, industry resource classification systems or similar things are not relevant in considering the ordinary meaning of exploration, or the phrase 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA.

Examples

16. Examples 2 to 6 build upon Example 1. Each of these examples reflects various activities that may occur in discovering petroleum and establishing whether development of the find is economically or commercially feasible/viable, and if it is, the best way to develop it.

17. Each of the examples addresses the question of whether the operations and facilities carried on or provided are 'involved in or in connection with exploration for petroleum' for the purposes of paragraph 37(1)(a) of the PRRTAA. Where the operations and facilities carried on or provided are not 'involved in or in connection with exploration for petroleum' for the purposes of paragraph 37(1)(a), the expenditure incurred on such operations and facilities may potentially fall within paragraph 38(1)(a) of the PRRTAA. This question is not considered further in the examples. The intent of the examples is to illustrate what is or is not covered by the phrase 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA (the paragraph 37(1)(a) phrase). No inference should be drawn from the examples about whether expenditure and activities not covered by the paragraph 37(1)(a) phrase are otherwise covered by another provision of the PRRTAA, nor what studies or activities are relevant in any particular case for assessing the commerciality or development potential of a particular find.

Example 1 – Appraisal wells

18. The joint venture participants (JVPs) in an exploration permit have drilled the Seagulls #2 well and discovered a large accumulation of water and CO_2 soaked natural gas in deep water some 250 kilometres from the Australian mainland (the 'Seagulls gas', the 'resource' or 'gas-in-place'). Under the Society of Petroleum Engineers, World Petroleum Council, American Association of Petroleum Geologists, Society of Petroleum Evaluation Engineers - Petroleum Resources Management System (SPE-PRMS) guidelines, the JVPs cannot book 'reserves'.

19. The JVPs agree to fund the drilling of two appraisal wells and investigate various potential development scenarios. The scenarios considered for the Seagulls gas project are:

- Domestic gas (Domgas): a deepwater platform to supply domestic gas into the Domgas pipeline
- Liquefied Natural Gas (LNG): a deepwater platform linked to an LNG plant somewhere onshore, and
- Gas to Liquids (GTL): a deepwater platform linked to an onshore plant to convert the gas to a liquid oil equivalent.

20. The two appraisal wells help delineate the accumulation and also investigate the physical and chemical properties of the petroleum reservoir.

21. The drilling of the two appraisal wells would be covered by the paragraph 37(1)(a) phrase. They are operations and facilities carried on or provided in ascertaining the size of the discovery and appraising its physical characteristics. The investigations of the various potential development scenarios would not be covered by the paragraph 37(1)(a) phrase as they are directed towards investigating the development of the resource. These activities cannot be said to have a reasonably direct relationship with exploration.

Example 2 – Consideration of recovery methods

22. Continuing with the fact situation described in Example 1.

23. At the same time the engineering team's investigation into the deepwater platform reveals that if it is to be utilised, it will require substantial structural reinforcements which would be very costly. This high cost exceeds the potential earnings from both the Domgas and GTL options, and using these concepts the Seagulls gas is not commercially recoverable. Therefore, the extraction and sale of LNG is the only potentially commercial option. As the resource is still not commercial no reserves can be booked.

24. The carrying out of the work by the engineering team in investigating the deepwater platform is not covered by the paragraph 37(1)(a) phrase. The work undertaken is directed towards the development of the resource, not towards its discovery or ascertaining the size of the discovery or its physical characteristics. The activities can also not be said to have a reasonably direct relationship with exploration for petroleum.

Example 3 – Pre-Front End Engineering and Design (Pre-FEED) studies

25. Continuing with the fact situation described in Examples 1 and 2.

26. The JVPs agree to fund further investigations, a Pre-front end engineering and design (Pre-FEED) study, into an onshore LNG concept. The Pre-FEED studies narrow the multiple facility alternatives to select a single preliminary basis of design (BOD), that will require further analysis and refinement during front end engineering and design (FEED). The objective of the study is to identify and model the economics of the offshore and onshore LNG processing facilities with the intention of maximising the commercially recoverable gas from the resource.

27. The Pre-FEED studies involve multiple activities including drilling appraisal wells to further define the resource and evaluating the chosen concept (in this case an onshore LNG processing facility) by investigating the various environmental, regulatory, commercial, potential revenue streams and infrastructure issues. The integrated upstream and downstream LNG facilities will be designed specifically to process the Seagulls gas, therefore the chosen BOD needs to reflect this. The results of these various studies are then modelled to assess the probabilistic economic returns and whether or not to commence FEED.

28. The appraisal well activities undertaken as part of these Pre-FEED studies would be covered by the paragraph 37(1)(a) phrase, being operations and facilities directed towards ascertaining the size of the discovery and appraising its physical characteristics.

29. However, carrying out the work undertaken in the remaining Pre-FEED studies, that is, investigating, designing and modelling an onshore LNG processing facility concept, would not be covered by the paragraph 37(1)(a) phrase. This work is not directed towards discovery or ascertaining the size of the Seagulls gas discovery or its physical characteristics. These activities cannot be said to have a reasonably direct relationship with exploration for petroleum. Rather, these activities broadly relate to considering the best model for the recovery and exploitation of the resource.

Example 4 – Further studies undertaken prior to a final investment decision (FID)

30. Continuing with the fact situation described in Examples 1 to 3.

31. The JVPs agree to fund studies into the onshore LNG processing facility concept and BOD. This stage involves detailed technical and non-technical studies into the chosen onshore LNG processing facility concept and BOD. The results are used to determine the extent of the Seagulls gas-in-place which is commercially recoverable, and whether or not to make a FID. As they move through these studies, the needs and limitations of various aspects of the potential project are determined, and it may be necessary to rework the BOD to ensure all facilities are compatible and the overall LNG project design is technically and economically feasible. The level of design enables cost estimates to be made but is not sufficiently detailed to enable construction to proceed on this basis.

32. At the same time, to improve leasehold security over the Seagulls resource the JVPs apply to the relevant government authority for a retention lease (RL). As part of the RL requirements the JVPs agree to a work program to resolve the technical, commercial and other barriers to the recovery of gas.

33. The work program to be performed includes a 'Definition of the resource' program. This phase of the evaluation involves additional appraisal wells to further define the resource including evaluating its size, the chemical and physical properties of the geological structure and the pressure of the gas within the reservoir. Separately the overall work program also includes considering this information in the light of the gas volume and flow requirements of the offshore and onshore facilities.

34. In support of the 'Definition of the resource' work program, a specific project team is set up to plan and manage the additional appraisal well operations.

35. Also, further studies are commissioned in the following areas:

- Environmental studies.
- Social impact and heritage mitigation studies.
- State and Federal government – leases, permits and licences required.
- Joint Venture (JV) and commercial – understand potential LNG sales terms and revenue streams from production, and JV aggregation of gas.
- Land access – native title, road access, land acquisition, permit and building licence requirements.
- Infrastructure – service ports, airports and transport, accommodation and facilities requirements.
- Project controls – employee relations, safety controls, assurance and verification, risk identification and mitigation, contractual and tender preparation and project implementation plans and schedules.

36. Each of the different operations and facilities described above need to be considered individually to determine if they are covered by the paragraph 37(1)(a) phrase.

37. For example, operations and facilities carried on or provided as part of the definition of the resources work program outlined in paragraph 33 of this Ruling are covered by the paragraph 37(1)(a) phrase where they establish the extent of gas-in-place – that is, the size of the discovery and its physical location or determine its physical characteristics. However, operations and facilities directed to considering the information obtained in the light of the gas volume and flow requirements of the offshore and onshore facilities would be outside the paragraph 37(1)(a) phrase. This is because they are directed towards whether to or how to recover the gas and how to process and transport the gas recovered.

38. In addition, the appraisal well planning and management activities undertaken by the specific project management team would be covered by the paragraph 37(1)(a) phrase, being operations and facilities which have a reasonably direct relationship with exploration for petroleum as they assist in ascertaining the size of the discovery and appraising its physical characteristics.

39. However, the other operations and facilities are relevant to establishing matters other than the identification of the existence, extent and nature of the discovery and it cannot be said that there is a reasonably direct relationship between the operations and facilities and exploration for petroleum. They will not be covered by the paragraph 37(1)(a) phrase.

Example 5 – FEED

40. Continuing with the fact situation described in Examples 1 to 4.

41. FEED activities are commenced in relation to the integrated design of the upstream and downstream facilities. This involves conducting studies and producing engineering diagrams that refine the level of certainty of the chosen onshore LNG processing facility concept and BOD. These activities refine the specifications in terms of mechanical, electrical, pressure, motion, temperature and chemical requirements of all the facilities including those of the wells, platform, pipeline and LNG components.

42. Amongst other things, the FEED activities include:

- well studies and diagrams to document the required number and location of production wells, fines migration, fluid testing, borehole stability, and production wellhead design requirements.
- subsea pipeline studies and diagrams to document the required size, route, distance, capacity, temperature and pressure requirements.
- platform studies and diagrams to document the required location, ocean depth, size, weight, capacity, components and plant configuration requirements.
- LNG facility studies and diagrams to document the required location, size, capacity, components and plant configuration requirements to conform to the required well, subsea pipeline and platform arrangements.
- studies to evaluate the probabilistic economic returns using all of the above to cost the chosen onshore LNG processing facility concept and BOD sufficiently to enable decision makers to evaluate whether to make a positive FID and then proceed with building the project.

43. The operations and facilities carried on or provided as part of the FEED process described are not covered by the paragraph 37(1)(a) phrase. They are not directed to discovery of the resource, or understanding its nature, size, location and physical characteristics. Nor is there a reasonably direct relationship between the operations and facilities described and exploration for petroleum. The carrying on or providing of the operations and facilities described is directed towards the recovery and exploitation of the resource discovered.

Example 6 – Consideration of other project methodologies

44. Continuing with the fact situation described in Examples 1 to 5.

45. Near the conclusion of the FEED process, a decision is made to approve the commissioning of detailed design work on the proposed final BOD. Detailed design is needed to build the project facilities, as the level of engineering design as at the end of FEED is not of itself executable. This early stage detailed design is used to expedite any possible construction after a positive FID, but alternatively will be a regret cost if FID is negative.

46. On the basis of the detailed technical and financial investigation into the chosen onshore LNG processing facility concept and BOD, the JVPs determine that there are no commercially recoverable reserves and decide not to proceed with the proposed development. The costs incurred on Pre-FEED, FEED and detailed design are all written off and the JVPs are still not able to recognise any reserves associated with the Seagulls gas.

47. Some time after the negative FID for the chosen onshore LNG processing facility concept, the JVPs determine to consider new scenarios for the Seagulls resource by accessing new technology. The JVPs 'recycle' the investigation process to commercialise the gas, by again committing to a concept scenario study and selection process. The JVPs retain the RL status of the permit as they recommit to government to resolve the barriers to commercialising the Seagulls resource. To further pursue the process of establishing the extent, if any, of commercially recoverable reserves, the JVPs then choose a floating LNG concept to pursue further. The parties commit to fund a Pre-FEED concept evaluation and BOD selection studies. This is followed by a FEED investigation into a floating LNG concept and BOD. The nature of Pre-FEED and FEED activities completed in respect of the floating LNG concept are similar to those performed in respect of the original chosen onshore LNG processing facility concept.

48. Although highly technical, the floating LNG concept removes the need for a costly deepwater platform and onshore land tenure costs, and as such, this option proves to be economic. The JVPs make a positive FID on the selected BOD. They apply to government for approval to develop the field and request to have production licences issued. Only now can the JVPs recognise '1P reserves' in accordance with the SPE-PRMS guidelines. The JVPs commence detailed design and the development of the facilities to commercialise LNG from the Seagulls gas.

49. Carrying on or providing the project methodology operations and facilities described above is not covered by the paragraph 37(1)(a) phrase. The operations and facilities are not directed to discovery of the resource, or understanding its nature, size, location and physical characteristics. Nor is there a reasonably direct relationship between the operations and facilities described and exploration for petroleum. The operations and facilities described are directed towards determining the method of recovery and exploitation of the resource discovered.

Example 7 – Consideration of alternative project methodologies

50. The JVPs in an exploration permit area discover a large accumulation of gas (the Eagles 'field', 'gas' or 'resource'). They then enter into concept studies to investigate the various options to commercially exploit the resource. As a result, the JVPs choose a deepwater platform with a standalone onshore LNG plant as the concept to investigate further with a view to recognising the gas as a reserve under the SPE-PRMS guidelines.

51. The JVPs commit to fund pre-FEED concept evaluation and BOD selection studies. The object of this phase is to investigate and model the economics of an onshore LNG processing facility that maximises the commercially recoverable petroleum from the Eagles field. This step involves investigating the various challenges of exploiting the resource including environmental, social, regulatory, land tenure, infrastructure and commercial issues. Pre-FEED studies to narrow the multiple facility alternatives and select a preliminary BOD are also conducted. The results of these various studies are then modelled to assess the probabilistic economic returns and whether or not to commence FEED. See Example 3 for more details on the activities undertaken as part of this stage of the process.

52. Unfortunately, the forecast development of this concept is clearly uneconomic even at the Pre-FEED stage. Although LNG is a saleable product and the Eagles resource shows good flow rates, the vast cost of a standalone onshore plant makes the option of a standalone onshore LNG processing facility uncommercial. Therefore the JVPs do not agree to support further funding or proceed with this concept. No reserves are able to be booked under the SPE-PRMS guidelines.

53. Following the negative decision to proceed with the standalone onshore LNG processing facility concept, the JVPs determine to 'recycle' the investigation process to commercially exploit the gas. They return to the concept studies and selection process and consider various new and varied concept scenarios. The concept eventually chosen this time for the Eagles gas is to bring in new JVPs with other stranded resources to share the onshore facilities (third party LNG option).

54. To further pursue the process of establishing the extent, if any, of commercially recoverable reserves, the Eagles JVPs then agree to fund further investigations into the chosen third party LNG option. The Eagles JVPs commit to fund Pre-FEED concept evaluation and BOD selection studies. The studies show that by using the third party LNG option to share the LNG facility, volumes will increase and it may be commercially viable to recover the gas.

55. The Eagles JVPs then commit to commence FEED studies into the third party LNG option and BOD. Refer to Example 5 for more details on the activities undertaken as part of this stage of the process.

56. Although commercially more complex, the third party LNG option is both technically possible and commercially feasible. Sharing the cost of the onshore facilities makes the third party LNG option for the Eagles gas commercially viable. The JVPs in the Eagles gas and the JVPs in the downstream LNG plant then make a positive FID on the third party LNG option. The Eagles JVPs are then able to recognise '1P Reserves' in accordance with the SPE-PRMS guidelines. The Eagles JVPs then apply for production licences and commence detailed design for the development of the reserves and construction of the facilities.

57. Carrying on or providing the alternative project methodology operations and facilities described in this example is not covered by the paragraph 37(1)(a) phrase. The operations and facilities are not directed to discovery of the resource, or understanding its nature, size, location and physical characteristics. Nor is there a reasonably direct relationship between the operations and facilities described and exploration for petroleum. The operations and facilities described are directed towards determining the method of recovery and exploitation of the resource discovered.

Example 8 – Another LNG case

58. In year one, a LNG company undertakes various activities to identify a potential petroleum pool. This includes recovering a sample to surface, and analysing its hydrocarbon composition. These operations are covered by the paragraph 37(1)(a) phrase, involving searching for or evaluation of the nature of the discovery – its location and physical characteristics.

59. Plans were drawn up at the company's head office to detail and schedule relevant exploratory operations. This is also covered by the paragraph 37(1)(a) phrase, as it has a reasonably direct relationship to exploration for petroleum. It has a substantial relation, in a practical business sense, to exploration for petroleum and it facilitates and advances that exploration.

60. In year two, a number of appraisal wells are drilled, and estimates are made of resource 'in-place'. The vertical and lateral boundaries of the petroleum pool are established using various seismic tests. This is covered by the paragraph 37(1)(a) phrase. It involves searching for and physically appraising what is found. A 'scouting' study is also undertaken to give an idea of how an integrated project might look and gives a rough estimate of costs (at +/- 35%). This activity is not covered by the paragraph 37(1)(a) phrase. It goes beyond establishing the location, size and physical characteristics of the find. There is not a reasonably direct relationship with exploration for petroleum. Rather, it considers the feasibility of a potential project to develop the find.

61. A preliminary environmental impact study is also undertaken, the results of which indicate that a project could be sustainable. This is not covered by the paragraph 37(1)(a) phrase. It goes beyond establishing the location, size and physical characteristics of the find. There is not a reasonably direct relationship with exploration for petroleum. It considers the likelihood that a potential project to develop the find will obtain the necessary developmental approval from the relevant government authority.

62. In year three, it is decided to test a range of plausible development models for feasibility. After undertaking some research and development work, and evaluation of competing technologies, a BOD is determined with costs estimated at +/- 25%. This is not covered by the paragraph 37(1)(a) phrase for the same reason as stated in paragraph 60 of this Ruling.

63. As a result of this work, the company board decides to proceed to FEED.

64. The FEED process is undertaken in years four to six. It is concluded that the project can be developed. Reserves are identified under the SPE-PRMS guidelines. FEED is not covered by the paragraph 37(1)(a) phrase where it goes beyond establishing the location, size and physical characteristics of the find. There is not a reasonably direct relationship with exploration for petroleum.

65. Work is then undertaken to detail fully the project specifications and costs. Cost estimates are narrowed to +/- 10% and exact drawings and equipment specifications for suppliers and contractors are drawn up. Firm quotes are obtained on key equipment to enable a more precise project cost estimate. Negotiations commence with potential buyers for the LNG, and various financial and marketing feasibility studies are entered into. Negotiations are also undertaken with suppliers, contractors and governments. At this point, certain long-lead equipment items are also ordered in anticipation of and in advance of a favourable FID. This is not covered by the paragraph 37(1)(a) phrase as it goes beyond establishing the location, size and physical characteristics of the find. Again, there is not a reasonably direct relationship with exploration for petroleum. It is directed to the development and exploitation of the find.

66. At the beginning of year 7, the LNG Company makes a favourable FID, relevant agreements and contracts are made, the company obtains relevant production licences, and commences development drilling and construction work.

67. In year 9, production commences.

68. Note that if instead a BOD could not be developed because of technical feasibility problems at the end of year 3 and a retention lease was obtained, it would not change the purpose and nature of the operations and facilities.

Date of effect

69. This Ruling applies to expenditure incurred from 21 August 2013 (the date of issue of the Draft Taxation Ruling TR 2013/D4 *Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?* (TR 2013/D4)). However, if the Commissioner is asked or required to state a view (for example in a private ruling or in submissions in a litigation matter) in respect of expenditure incurred on or before 21 August 2013, the Commissioner will do so consistently with the views set out in this Ruling. In any case this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of TR 2013/D4 (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

70. Prior to the issue of TR 2013/D4, the Commissioner had an approach, contrary to the views contained in this Ruling (and TR 2013/D4), of accepting that a wider range of feasibility expenditure fell within the meaning of exploration expenditure in section 37 of the PRRTAA. The Commissioner will communicate to Industry and affected taxpayers how he will apply compliance resources in relation to expenditure incurred on or before 21 August 2013.

Commissioner of Taxation
17 December 2014

Appendix 1 – Explanation

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

Introduction

71. Paragraph 37(1)(a) of the PRRTAA provides:

> For the purposes of this Act, a reference to exploration expenditure incurred by a person in relation to a petroleum project is a reference to payments (not being excluded expenditure), whether of a capital or revenue nature, to the extent that they are made by the person:
>
> (a) in carrying on or providing operations and facilities involved in or in connection with exploration for petroleum in the eligible exploration or recovery area in relation to the project; and
>
> …

72. The scope of 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA has significant practical implications for persons to whom the PRRTAA applies.

73. Exploration expenditure in relation to a project under section 37 of the PRRTAA may qualify for transfer to another project (which is not the case for general project expenditure under section 38 of the PRRTAA) and a more favourable rate of augmentation applies than that which applies to general project expenditure.

74. While there is no real doubt that traditional searching activities directed at seeking to discover a resource and the appraisal of its physical characteristics are 'exploration', the question has arisen whether 'exploration for petroleum' in the context of paragraph 37(1)(a) of the PRRTAA includes non-exploration evaluation activities such as post-discovery work directed at establishing whether development of the find is economically or commercially feasible or viable, and if it is, the best way to develop it.

75. If carrying on or providing the operations and facilities involved in these types of activities are not 'exploration for petroleum', it then becomes relevant whether they might be considered to be 'in connection with' exploration for petroleum.

76. If they do not qualify as exploration expenditure under section 37 of the PRRTAA, they may potentially qualify for inclusion as general project expenditure under section 38 of the PRRTAA. Expenditure that satisfies the requirements in section 38 can receive recognition as general project expenditure once there is a petroleum project in relation to a production licence (that is in force).

77. However, unlike exploration expenditure, a deduction in respect of general project expenditure is not transferable to other petroleum projects.

78. The Commissioner considers that operations and facilities 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA embraces:

(a) exploration within its ordinary meaning. That is, the discovery and identification of the existence, extent and nature of petroleum. This involves searching for petroleum within the eligible exploration or recovery area in relation to the project[6] and appraising the physical aspects of a discovery, such as its location, size and physical characteristics; and

(b) such other operations and facilities as have a reasonably direct relationship to those exploration activities.

Meaning of 'exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA

79. In *Woodside Energy Ltd v. Federal Commissioner of Taxation (No 2)* [2007] FCA 1961 at paragraph 261, French J (as he then was) said:

> It is necessary as always to begin the task of construction by reference to the words of the Act applying their relevant ordinary meaning ascertained by reference to context and legislative purpose unless some technical or special meaning is indicated.[7]

80. Neither the term 'exploration' nor 'exploration for petroleum' is defined in the PRRTAA and these words ought to be construed according to their ordinary and natural meaning in the context of the PRRTAA as a whole.

81. There is no indication in the PRRTAA (or in the associated extrinsic materials) that the term 'exploration' carries a meaning other than its ordinary meaning. Nor does the PRRTAA provide any basis for preferring a trade usage of exploration over the ordinary meaning of the term.[8]

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[6] Generally speaking, where the production licence is granted after 30 June 2008, or the project is an onshore petroleum project or the North West Shelf project, the relevant area is determined with regard to the petroleum exploration permit area, retention lease area and/or the production licence area under the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (OPGGSA) or a similar area under an authority or right, however described, under another Australian law (see section 2 and subsections 5(5) to 5(7) of the PRRTAA; for pre 1 July 2008 production licences see subsections 5(1) to 5(4) of the PRRTAA).

[7] See *ZZGN and Commissioner of Taxation* [2013] AATA 351 (*ZZGN*) at paragraph 283.

[8] See *ZZGN* at paragraphs 312 to 314.

82. 'Exploration' is an ordinary English word. It is not a technical word, although its application in particular circumstances might involve technical questions.

> In the *Shorter Oxford Dictionary* (1973) p 707 'exploration' is defined as '1. The action of examining; scrutiny … 3. The action of exploring …'. 'Explore' is defined as '1. … seek to find out; to search for; to make proof of … 3. … to go into or range over for the purpose of discovery … 4. … to conduct operations in search for'.[9]
>
> The *Macquarie Dictionary* defines 'exploration' as 1. the act of exploring. 2. the investigation of unknown regions. 'Exploration licence' is defined as a licence granted for a specific time to explore a large section of country with a view to prospecting. ; 'Explore' is defined as 1. to traverse or range over (a region, etc) for the purpose of discovery. 2. to look into closely; scrutinise; examine. 3. *Surgery* to investigate, especially mechanically, as with a probe, 4. *Obsolete* to search for; search out.
>
> The *Oxford English Dictionary* defines 'exploration' as 1. The action of examining; investigation, scrutiny, Obs. 2. The action of exploring (a country, district, place, etc); an instance of this. Also *transf* 'Explore' is defined as 1.**a**. To investigate, seek to ascertain or find out (a fact, the condition of anything). **b**. To search for; to find by searching; to search out. *Obs* 2.**a**. To look into closely, examine into, scrutinize; to pry into (either a material or immaterial object). In later use coloured by association with 3.**b**. To examine by touch; to probe (a wound). 3.**a**. *esp*. To search into or examine (a country, a place, etc) by going through it; to go into or range over for the purpose of discovery. Fig. phr. *To explore every avenue* (or *to explore avenues*), to investigate every possibility. **b**. *intr*. To conduct operations in search *for*. **c**. To make an excursion; to go on an exploration (*to*).

83. The meaning is readily grasped in relation to exploration for petroleum. Searching in order to discover petroleum is the core concept. The ordinary meaning would not be limited merely to discovering the fact that a field or petroleum pool existed, but would include determining the size of the field or pool and the physical characteristics of the petroleum within the field or pool. In other words, discovering the existence, extent and nature of the resource would be within the description 'exploration'. It is the systematic search for petroleum, and the subsequent determination of the extent (in the full physical sense, including chemical composition) of those discoveries.

84. The appraisal of the extent and nature of a field or petroleum pool might be a considerable exercise, which may involve recovery of some of the resource in the course of the exploration – drilling an appraisal well and extracting a sample of the resource for testing is an example.

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[9] See *Re BHP Pty Ltd and Collector of Customs* [1987] AATA 13; (1987) 11 ALD 413 (*BHP*) at page 420.

85. The view expressed above as to the meaning of exploration for petroleum is consistent with statements in *ZZGN and Commissioner of Taxation* [2013] AATA 351 (*ZZGN*). In *ZZGN*, President Kerr and Senior Member Walsh (the Tribunal) were required to consider whether certain expenditure was 'exploration expenditure' for the purposes of paragraph 37(1)(a) of the PRRTAA. The Tribunal made a number of statements about the meaning of exploration for the purposes of paragraph 37(1)(a). The Tribunal considered that:

> …there is nothing in the legislative history of the PRRTA Act or in the extensive case law referred to by either counsel to suggest that the term 'exploration' should be read as meaning other than its ordinary meaning understood in the context in which it appears.[10]

86. When considering the ordinary meaning of exploration the Tribunal found that:

> …as a matter of fact, that in the context of s 37(1) of the PRRTA Act, the ordinary meaning of the word contemplates the use of any range of survey techniques to identify prospective oil or gas fields. Those survey techniques would include, but not be limited to, geological, gravity magnetic, seismic (2D and 3D) and geometrical surveys together with any scientific or technical analysis necessarily associated with evaluating their results. 'Exploration' also includes the drilling of appraisal wells to provide a more accurate indication of the potential size and quality of the oil and gas reserves. However, the ordinary meaning of the word 'exploration' does not, in the Tribunal's view, extend to include feasibility studies of the field for future development and production.[11]

87. The approach taken by the Tribunal in *ZZGN* is consistent with the approach taken in *BHP*. In that case, Deputy President Nicholson and Member Woodard were required to construe the word 'exploration' and the phrase 'other operations connected with exploration' in [then] section 164 of the *Customs Act 1901*. They held that 'exploration' is not a word with a technical or special meaning within the off-shore drilling industry and said:

> The words with which we are concerned here ('exploration' and 'prospecting') are not words of that type. They are words of common parlance. They are not given a juxtaposition which would indicate that they are being used other than in their ordinary sense. The words are to be interpreted, as was the word 'mining' in [*Re Cliffs Robe River Iron Associates and Collector of Customs* (1984) 6 ALN N255], in their everyday sense.[12]

88. Applying the dictionary meanings of the word 'exploration', they held that:

> Exploration takes place when exploring is being undertaken, when the search is being conducted for the purpose of discovery.[13]

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[10] See *ZZGN* at paragraph 312.
[11] See *ZZGN* at paragraph 322.
[12] See *BHP* at page 422.
[13] See *BHP* at page 422.

89. Although the *BHP* case was concerned with a different statutory context, the ordinary meaning of the word 'exploration' was applied.

Meaning of operations and facilities 'involved in or in connection with' exploration for petroleum

90. It has been argued that the words 'in connection with' in paragraph 37(1)(a) of the PRRTAA expands the meaning of the concept of exploration in this statutory context so that it can encompass not only operations and facilities involved in searching for, and identifying, a discovery, but also operations and facilities directed towards ascertaining whether future production is or is not economically or commercially feasible/viable, including whether or not to make a decision to produce or FID.

91. Paragraphs 93 to 112 of this Ruling explain why it is considered that the phrase 'involved in or in connection with' does not alter the ordinary meaning of exploration for petroleum, but does expand the operations and facilities covered beyond that which is directly involved in exploration for petroleum where a reasonably direct relationship is shown to exist between the operations and facilities and exploration for petroleum.

92. Paragraphs 113 to 127 of this Ruling explain why it is considered that operations and facilities carried on or provided on non-exploration evaluation activities, such as those directed towards ascertaining whether future production is or is not economically or commercially feasible/viable, including whether or not to make a decision to produce or FID, are not considered to be 'in connection with' exploration for petroleum.

'Involved in or in connection with'

93. The Commissioner considers that the phrase 'involved in or in connection with' does not extend the ordinary meaning of 'exploration for petroleum' (discussed above).

94. This is because the phrase is looking at the relationship that exists between operations or facilities and the ordinary meaning of exploration for petroleum. The phrase does not provide that where a relevant relationship exists, the operations or facilities are exploration in terms of its ordinary meaning. Rather, paragraph 37(1)(a) of the PRRTAA provides that expenditure incurred on such operations or facilities (in terms of the paragraph) can be 'exploration expenditure'. The effect of this is that the phrase can expand the operations and facilities covered by paragraph 37(1)(a) beyond those directly involved in exploration for petroleum.

95. The Commissioner is of the view that this approach is consistent with the Tribunal's decision in *ZZGN* and evident in the discussion that follows.

'Involved in'

96. The operations and facilities 'involved in … exploration for petroleum' are those that have a direct and immediate connection with the act of exploration itself.

97. The concept 'involved in' must be understood reflexively, as Beaumont J (with whom Jenkinson and Lehane JJ agreed) stated in *Leppington Pastoral Company Pty Ltd v. Commonwealth* (1997) 76 FCR 318:[14]

> What, in this connection, is meant by 'involved in'? One of the dictionary definitions of the verb 'involve' is: 'to include, contain, or comprehend within itself or its scope'. It appears that the phrase 'involved in' was used here in this sense.[15]

'In connection with'

98. It has been said that the words 'connected with' (and similar terms) 'are capable of describing a spectrum of relationships ranging from the direct and immediate to the tenuous and remote'.[16]

99. One common meaning of the words 'in connection with' is to denote a 'relation between things one of which is bound up with, or involved in, another'.[17]

100. In each case, however, the nature and the closeness or remoteness of the connection and the extent of the relationship required must be determined by the statutory context.[18] In *Burswood Management Limited v. Attorney-General (Cth)* (1990) 23 FCR 144, where Lockhart, Wilcox and Hill JJ said:

> The words 'in connection with' are words of wide import; and the meaning to be attributed to them depends on their context and the purpose of the statute in which they appear. As *Davies* J said in *Hatfield:* 'Expressions such as 'relating to', 'in relation to', 'in connection with' and 'in respect of' are commonly found in legislation but invariably raise problems of statutory interpretation. They are terms which fluctuate in operation from statute to statute ... The terms may have a very wide operation but they do not usually carry the widest possible ambit, for they are subject to the context in which they are used, to the words with which they are associated and to the object or purpose of the statutory provision in which they appear.[19]

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[14] The case concerned the assessment of compensation following the compulsory acquisition of a parcel of land.
[15] See *Leppington Pastoral Company Pty Ltd v. Commonwealth* (1997) 76 FCR 318 at page 356 paragraph F.
[16] See *Collector of Customs v. Pozzolanic Enterprises Pty Ltd* (1993) 43 FCR 280 at page 288.
[17] See *Collector of Customs v. Cliffs Robe River Iron Associates* (1985) 7 FCR 271 at page 275 and *BHP*, at page 422.
[18] See *Woodside Energy Ltd v. Federal Commissioner of Taxation (No 1)* (2006) 155 FCR 357; [2006] FCA 1303 at paragraph 57.
[19] See *Burswood Management Limited v. Attorney-General (Cth)* (1990) 23 FCR 144 at page 146.

101. The Tribunal in *ZZGN* considered the meaning of the phrase 'involved in or in connection with' exploration. They stated, in relation to the term 'in connection with', that:

> In our opinion s 37 should be considered and interpreted in light of the rich legislative history of the section and the statute, to ascertain its purpose. The sufficiency of any 'connection' intended to be consigned by the words 'in connection with' is a matter of judgment which requires us to consider the subject matter, the legislative history and the facts of the case.[20]

102. The matter must be resolved on the basis of whether or not the operation or facility is, or is not, sufficiently in connection with exploration for petroleum.[21]

103. In *ZZGN*, the Tribunal reached the following conclusion as to what is required to demonstrate the requisite connection with exploration:

> In our opinion there must be shown to be a reasonably direct relationship between the 'operations' for which expenditure has been incurred and 'exploration' for there to exist a relevant connection between the two. That conclusion is consistent with the Commissioner's contention that remote and indirect connections will not suffice.[22]

Reasonably direct relationship with exploration for petroleum

104. Whether an operation or facility has the relevant connection with exploration for petroleum will be a question of fact and degree to be determined in all the circumstances.

105. In the Commissioner's view, in considering whether a particular operation or facility has a reasonably direct relationship with exploration for petroleum, it is the objective circumstances which are relevant rather than any subjective purpose.

106. Paragraphs 107 and 108 of this Ruling provide some useful 'rules of thumb' or 'benchmarks' that may assist when considering if an operation or facility has a reasonably direct relationship with exploration for petroleum. It is important to note that these cannot be determinative or substituted for the words of the statute.[23]

107. In order to determine if a particular operation or facility could be characterised as an operation or facility 'in connection with exploration for petroleum', consideration may be given to whether the work done was directed at benefiting, assisting, advantaging, or facilitating the activity of exploration (being the discovery and identification of the existence, extent and nature of petroleum).

108. An operation or facility may also be 'in connection with' exploration for petroleum if it shared a substantial relation, in a practical business sense, with the activity of exploration.

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[20] See *ZZGN* at paragraph 378.
[21] See *ZZGN* at paragraph 394.
[22] See *ZZGN* at paragraph 390.
[23] See *ZZGN* at paragraphs 391 to 397.

109. An operation or facility may have a relevant connection with exploration for petroleum notwithstanding that exploration, or further exploration, does not actually proceed. For example operations or facilities may be carried on or provided in assessing and determining whether exploration work or additional exploration will be undertaken at all. The Commissioner considers that expenditure incurred on such operations and facilities could be in connection with exploration for petroleum whether or not any further exploration was undertaken.[24]

110. *ZZGN* considered a range of operations and facilities and whether a reasonably direct relationship existed with exploration for petroleum.[25] Some of the operations and facilities identified by the Tribunal as having a relevant connection to exploration for petroleum were:

- sub-surface modelling and field modelling, to estimate reservoir volumes and consider further work required to gain greater certainty.
- preparation of a detailed 3-D full field modelling report relating to geophysical, geological modelling and probabilistic volumetric analysis.
- certain project management activities in support of sub-surface evaluation operations.

111. These activities have a reasonably direct relationship with exploration for petroleum where they are directed to understanding the discovery and identification of the existence, extent and nature of petroleum. That is, where they are directed to understanding the possibility of resources existing and the nature, size and location of the resource that has been discovered.

112. It is also relevant to note that the words 'in connection with' are used in conjunction with 'involved in' and imply a broader relationship between the operations and facilities in question and 'exploration for petroleum' than that implied by the words 'involved in'.[26]

Not operations and facilities carried on or provided to evaluate the discovery, such as whether it is economically feasible to develop or how best to develop it

113. Once petroleum is discovered, operations and facilities carried on or provided to evaluate the discovery (non-exploration evaluation activities) are not involved in or in connection with 'exploration for petroleum'. An example of this is evaluation of the economic or technical feasibility of developing a find, or how best to develop it.

[24] See *ZZGN* at paragraph 396.
[25] For example see *ZZGN* at paragraphs 401 to 411.
[26] See *ZZGN* at paragraph 384.

114. This is because such operations and facilities do not fall within the ordinary meaning of exploration in paragraph 37(1)(a) of the PRRTAA[27] and they do not have a reasonably direct relationship to exploration for petroleum (within the ordinary meaning of that term).

115. There is not a reasonably direct relationship because the operations and facilities are directed to evaluating the discovery in terms of development or production, rather than exploration for petroleum.

116. More specifically, studies which investigate the economic/commercial (including technical) feasibility/viability of development or production after the resource has been discovered do not come within paragraph 37(1)(a) of the PRRTAA. However, they may come within paragraph 38(1)(a) of the PRRTAA in which case expenditure on such studies can receive recognition as general project expenditure once there is a petroleum project in relation to a production licence (that is in force).

117. There are several reasons for this view.

118. Firstly, such feasibility studies do not come within the ordinary meaning of exploration for petroleum which is considered to be limited to searching for, and physical appraisal of the resource, and section 37 of the PRRTAA does not explicitly include them.[28]

119. Secondly, these feasibility studies do not have a reasonably direct relationship to exploration for petroleum (within its ordinary meaning). They are often related to considering whether to proceed to development or how best to develop a known discovery.

120. Thirdly, such studies are expressly mentioned in paragraph 38(1)(a) of the PRRTAA. The Senate Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987, especially the last sentence in the quote below, conveys a strong intention for feasibility or environmental studies to be covered by paragraph 38(1)(a) of the PRRTAA:

> Payments of a capital or revenue nature liable to be made by a person (not being excluded expenditure, exploration expenditure or closing-down expenditure in terms of clauses 44, 37 and 39 respectively) will be taken by paragraph (a) to be general project expenditure where they are liable to be made in carrying on or providing operations and facilities involved in establishing the project. Specifically included in such expenditure are payments liable to be made in carrying out any feasibility or environmental study.[29]

121. It is noted that paragraph 38(1)(a) of the PRRTAA and the Senate Explanatory Memorandum refer to 'any' feasibility or environmental study in the context of operations and facilities preparatory to the recovery of petroleum and other specified activities (or involved in establishing the project).

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[27] See *ZZGN* paragraphs 315 and 322.
[28] See *ZZGN* at paragraph 322.
[29] Clause 38 of the Senate Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987.

122. It is also clear from clause 38 of the Senate Explanatory Memorandum on section 38 of the PRRTAA that this section is intended to have application in relation to certain expenditure that pre-dates the obtaining of a production licence and hence a petroleum project for PRRT purposes (including feasibility studies). That is, the section is not limited to expenditure at or near the time a production licence is obtained.

> This clause describes amounts of expenditure which constitute general project expenditure incurred by a person in relation to a petroleum project. That expenditure, unlike exploration expenditure, is project-specific although it can include general project expenditure incurred prior to the granting of a production licence (for example, expenditure on a feasibility study prior to the grant of that licence).

123. It is also evident that general project expenditure in section 38 of the PRRTAA is not limited to amounts incurred shortly before a production licence is obtained. Sections 33, 34A and 35 of the PRRTAA make it plain that expenditure incurred more than five years before the obtaining of a production licence may qualify under section 38. For example, an environmental study would normally be undertaken well before a FID or a decision to produce.

124. In light of the above, the exclusion for exploration expenditure in subsection 38(1) of the PRRTAA has only a narrow potential for operation in relation to feasibility studies. Feasibility studies will in most cases be covered by paragraph 38(1)(a) of the PRRTAA and not section 37 of the PRRTAA.

125. Feasibility and environmental studies and other preparatory activities, however, may fall within paragraph 37(1)(a) of the PRRTAA where there is shown to be a reasonably direct relationship between those operations or facilities and exploration for petroleum.[30] That is, they are in connection with exploration.

126. For example, feasibility studies that address whether or not to continue exploring may be 'in connection with' exploration for petroleum in the context of paragraph 37(1)(a) of the PRRTAA. Expenditure incurred on such studies could be covered by the exclusion in subsection 38(1) of the PRRTAA to the extent that such expenditure would otherwise be general project expenditure (preparatory to recovery of petroleum and other specified activities).

127. A further point to note is that in the income tax context, paragraph 40-730(4)(c) of the ITAA 1997 expressly includes post-discovery economic feasibility studies as exploration. Such an extension does not appear in the concept of exploration for PRRT purposes in section 37 of the PRRTAA. While the income tax definition cannot govern the interpretation of section 37 of the PRRTAA, its structure by comparison can highlight points of difference.[31]

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[30] See *ZZGN* at paragraph 400.
[31] See *ZZGN* at paragraphs 248 to 250.

Other matters

128. There is no basis in the PRRTAA or relevant extrinsic materials for the view that regulatory regimes (for example, in respect of retention leases), 'phases' of activities, industry resource classification systems (for example the SPE-PRMS) in respect of the classification of reserves, an entity's own processes to determine whether or not to develop a discovery (for example FID), or similar things have a bearing on the ordinary meaning of exploration, or upon the phrase 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a) of the PRRTAA.[32]

129. The Tribunal in *ZZGN* were of the view that the construction of section 37 of the PRRTAA must be discerned from the terms of the PRRTAA alone (aided as appropriate by relevant extrinsic materials).[33]

[32] See *ZZGN* at paragraphs 312-315, 319, 321-322, 387 and 389.
[33] See *ZZGN* at paragraphs 250, 315 and 378.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Meaning of exploration includes ascertaining if a discovery is commercially viable

130. The meaning of exploration in paragraph 37(1)(a) of the PRRTAA, when taken in its statutory context, is not limited to the discovery and identification of the existence, extent and nature of petroleum, but extends to evaluating, appraising and scrutinising a potential project after a discovery has been made to ascertain whether production might be economically or commercially viable.

131. This meaning is consistent with the exploration phase concept used in the Petroleum Industry. The exploration phase of a project includes activities in relation to the discovery and determination of a commercially recoverable amount of a resource which supports a decision to mine. The decision to mine is a pivotal point between the exploration and development phases of a project.

132. The meaning of exploration for taxation purposes at the time the PRRTAA was introduced to parliament was generally understood to include activities such as feasibility studies undertaken to determine the commercial viability of a discovery. There is nothing to suggest that the meaning of exploration in the PRRTAA should not adopt a similar approach as parliament was aware of the taxation meaning at the time the PRRTAA was introduced.

133. The Commissioner considers that there is no indication in the PRRTAA (or in relevant extrinsic materials) that the term 'exploration' carries a meaning other than its ordinary meaning. Nor does the PRRTAA provide any basis for preferring a trade usage of 'exploration' over the ordinary meaning of the term. The ordinary meaning does not include considering if a discovery is commercially viable.[34] The Commissioner is of the view that this is consistent with the Tribunal's decision in *ZZGN.*[35]

134. In the Commissioner's opinion, the meaning of exploration under other statutes such as the Income Tax Assessment Acts, which have their own legislative history, purpose and context, does not govern the interpretation of the term for the purposes of the PRRTAA.[36] The Commissioner is of the view that this approach is consistent with the Tribunal's decision in *ZZGN*.[37]

[34] See paragraphs 3 to 8 of this Ruling.
[35] See *ZZGN* at paragraphs 312 to 322.
[36] See paragraph 13 of this Ruling.
[37] See *ZZGN* at paragraphs 248 to 250.

The Commissioner's view is too narrow as the facts in ZZGN are not representative of the Petroleum Industry.

135. The Commissioner's view on the meaning of exploration in paragraph 37(1)(a) of the PRRTAA is heavily based on the decision in *ZZGN* which had a particular fact pattern that is not representative of the broader activities undertaken in the Petroleum Industry.

136. In the Commissioner's opinion, the Tribunal reached their view on the meaning of exploration by considering the proper construction of section 37 of the PRRTAA, as discerned from the terms of the Act and relevant extrinsic materials, before applying these views to the particular facts before them. The considered views of the Tribunal on the meaning of exploration are not dependent on the particular facts of that case.

The Commissioner's view could result in black-hole expenditure

137. The Commissioner's view could create black-hole expenditure in the sense that certain expenditure may not be recognised at all for PRRT purposes, or that expenditure may be recognised, but may never be able to be utilised if a project or potential project is not successful.

138. In the Commissioner's opinion, payments that do not satisfy the requirements for exploration expenditure in section 37 of the PRRTAA, may still be deductible where they satisfy the requirements for general project expenditure in section 38.[38] For example, payments made for the purpose of making a decision to mine may fall in this category.

139. The Commissioner also considers that the PRRTAA contemplates there may be instances where expenditure in relation to a project or a potential project may not be able to be utilised by a person. For instance, the augmentation rate used to uplift expenditure that has not been utilised in a year of tax includes a premium that takes into account the possibility that it may not be utilised if a project or potential project is unsuccessful.[39]

[38] See paragraph 8 to 10 of this Ruling.
[39] See Australia Treasury, 1990, *Budget speech and papers Numbers 1-4*,(1990-91) Australian Government Publishing Service, Canberra at page 4.6, See also the Second Reading Speech to the *Petroleum Resource Rent Legislation Amendment Bill 1991*, House of Representatives, *Debates* (1991) at 3435.

Appendix 3 – Detailed contents list

140. The following is a detailed contents list for this Ruling:

References

Previous draft:

TR 2013/D4

Related Rulings/Determinations:

TR 2006/10

Subject references:

- exploration or prospecting
- feasibility study expenses
- mining & petroleum
- petroleum exploration expenses
- PRRT
- PRRT deductible expenditure
- PRRT exploration expenditure
- PRRT general project expenditure

Legislative references:

- TAA 1953
- PRRTAA 1987 2
- PRRTAA 1987 5(1)
- PRRTAA 1987 5(2)
- PRRTAA 1987 5(3)
- PRRTAA 1987 5(4)
- PRRTAA 1987 5(5)
- PRRTAA 1987 5(6)
- PRRTAA 1987 5(7)
- PRRTAA 1987 Pt IV
- PRRTAA 1987 19
- PRRTAA 1987 19(4)
- PRRTAA 1987 33
- PRRTAA 1987 34A
- PRRTAA 1987 35
- PRRTAA 1987 37
- PRRTAA 1987 37(1)(a)
- PRRTAA 1987 38
- PRRTAA 1987 38(1)
- PRRTAA 1987 38(1)(a)
- ITAA 1997 40-730(4)
- ITAA 1997 40-730(4)(c)
- Customs Act 1901 164
- Offshore Petroleum and Greenhouse Gas Storage Act 2006

Case references:

- Burswood Management Limited v. Attorney-General (Cth) (1990) 23 FCR 144
- Collector of Customs v. Cliffs Robe River Iron Associates (1985) 7 FCR 271
- Collector of Customs v. Pozzolanic Enterprises Pty Ltd (1993) 43 FCR 280
- Leppington Pastoral Company Pty Ltd v. Commonwealth [1993] FCA 322; (1997) 76 FCR 318
- Re BHP Petroleum Pty Ltd and Collector of Customs [1987] AATA 13; (1987) 11 ALD 413
- Woodside Energy Ltd v. Federal Commissioner of Taxation (No 1) (2006) 155 FCR 357; [2006] FCA 1303; (2006) 64 ATR 379
- Woodside Energy Ltd v. Federal Commissioner of Taxation (No 2) (2007) 69 ATR 465; [2007] FCA 1961
- ZZGN and Commissioner of Taxation [2013] AATA 351

Other references:

- Senate Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987
- Second reading speech to the Petroleum Resource Rent Legislation Amendment Bill 1991, House of Representatives, *Debates,* (1991)
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