MT 2012/1EC - Compendium

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Ruling Compendium – MT 2012/1

This is a compendium of responses to the issues raised by external parties to draft MT 2011/D1 – Miscellaneous taxes: application of the income tax and GST laws to immediate transfer farm-out arrangements

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1.	*Characterisation of the arrangement - is there a benefit provided by the farmee to the farmor from the farmee's exploration work and, if so, is that benefit in the form of a service?* Comments put forward the view that: • the Ruling is wrong to state that the contractual consideration that passes between the farmor and the farmee are 'benefits that flow….from the farmee's exploration commitments'. Instead, the farmee's consideration is the binding promises that the farmee makes under the farm-out arrangement contract; • even though economic benefits may accrue to the farmor as a result of the contract being carried out does not mean that the farmee is providing those benefits to the farmor, nor does the purported provision of these benefits constitute a service; • the Ruling does not specifically identify what are the 'exploration benefits' and absent this there is no basis upon which to accept the Ruling's conclusions as to whether the said benefits are received by the farmor, provided by the farmee and constitute a service which is on revenue account; and • the Ruling does not rule that exploration benefits (that is, services) are provided to the farmor by the farmee thereby suggesting it is a rebuttable assumption and this of itself creates uncertainty undermining the intent behind the Ruling.	It remains the ATO view that if a farmee is required under an immediate transfer farm-out agreement to meet certain exploration commitments, there is some benefit to the farmor from that exploration. However, the view in the Ruling acknowledges that the exploration serves the farmee's own purpose and for this reason the market value of benefits to the farmor from the exploration may not equate with the amount to be spent by the farmee. The disparity between what is spent by the farmee, and what may be the (lesser) value of the exploration benefit provided to the farmor, recognises the inherent risk/reward of this type of unique arrangement and that the farmor may be bargaining at a time when it knows very little as to the 'true' value of the interest. Additional explanation has been added to the Ruling to explain why that exploration benefit is considered a service and thus a non-cash benefit received by the farmor (see paragraphs 85 to 94 of the Ruling).

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2.	*'Free-carry' arrangements not covered by the draft Ruling* Comments have raised the issue of a 'free-carry' arrangement not being covered by the Ruling. Under a 'free carry' arrangement, a farmee does not conduct exploration itself or through contractors. Rather, the farmee contributes to the joint venture account to meet joint venture cash calls to fund exploration and other joint venture expenses through the joint venture operator. Under a 'free carry' arrangement the farmee meets cash calls not only in respect of its interest but also in respect of the farmor's retained interest. That is, the farmor is 'free-carried' by the farmee. Such an arrangement is not covered by the draft Ruling because the arrangement, as described in the draft Ruling, requires that the farmee (that is, itself or through contractors) conducts the exploration activities on the mining tenement (see the first dot point in the second column of the table in paragraph 14). The Ruling does not therefore explain the income tax or GST consequences for 'free carry' arrangements.	The Ruling has been amended to cover 'free carry' arrangements. Example 2 (paragraph 75) has been added to illustrate the application of the income tax and GST law to such arrangements.
3.	*When the farmee begins to hold its interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997* Comments explain that, prior to conditions such as Foreign Investment Review Board or Ministerial approval being satisfied, the farmee does not exercise, or does not have a right to exercise immediately, any rights in relation to the interest in the mining tenement and therefore would not satisfy the requirements to hold the interest in the mining tenement under item 5 of section 40-40 of the ITAA 1997. Consequently, under a farm-out agreement that is conditional, those conditions will need to be taken into account in determining whether the farmee is in a position to exercise, or have a right to exercise immediately, the rights in relation to the interest in the mining tenement.	The Ruling has been amended to take account of these comments (see paragraphs 34 to 39 and 123 to 128 of the Ruling). In particular, if under an immediate transfer farm-out agreement activities cannot be carried out on the mining tenement by the farmee until the requisite approvals have been given under the applicable legislation then the farmee cannot exercise, or have a right to exercise, immediately the subject matter of the right before obtaining that approval. Further, it is recognised that the farmee may not have a right to become the legal owner of the interest in the mining tenement until requisite approvals have been obtained.

Issue No.	Issue raised	ATO Response/Action taken
4.	*Date of effect issues* Comments have suggested that the application clause be amended such that it applies to contractual arrangements entered into after 27 July 2011 rather than to a farm-out agreement dated on or after 27 July 2011. This is due to potentially adverse consequences for parties that have entered into immediate farm-out arrangements prior to the release of the draft Ruling.	The date of effect clause (paragraph 80) has been amended to: • state that the Ruling applies to an immediate transfer farm-out arrangement entered into after 27 July 2011 if the farmor started to hold the mining tenement that is the subject of the arrangement on or after 1 July 2001. This differs from the draft Ruling. The draft Ruling proposed to apply to agreements dated on or after 27 July 2011. As a consequence of the change to the date of effect clause, the Ruling would not, for example, apply to an arrangement that had been negotiated and the terms agreed to prior to 27 July 2011 even though the contract was signed just after 27 July 2011. This date of effect as opposed to a later date of effect (being the date the final Ruling issued) will ensure that those taxpayers who have entered into immediate transfer farm-out arrangements after the date of issue of the draft Ruling are not disadvantaged if they have relied upon views in the draft Ruling; and • ensure that the Ruling does have application if an interest in a mining tenement is acquired through Government grant rather than under a contract. The Ruling now refers to an interest the farmor started to hold on or after 1 July 2001. Further: • as the Ruling applies to arrangements entered into after 27 July 2011, the Ruling has no application to immediate transfer farm-out arrangements entered into on and from 1 July 2001 and the agreement is executed or the terms of the arrangement are finalised on or before 27 July 2011; and • the Ruling does not apply to an immediate transfer farm-out arrangement if the farmor started to hold the interest in the mining tenement (that is the subject of the arrangement) before 1 July 2001. In this case, Income Tax Ruling IT 2378 may be relevant.