TR 2020/5EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – TR 2020/5

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Taxation Ruling TR 2016/D3 *Income tax: application of section 6CA of the Income Tax Assessment Act 1936 and Australia's tax treaties and the payer's withholding obligations.* It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
1	The final Ruling should set out the full legislative definition of 'natural resource income' and should not paraphrase that definition. The draft Ruling does not specify that section 6CA of the *Income Tax Assessment Act 1936* (ITAA 1936) only applies to payments to the extent they are 'income'. The Ruling also fails to note that section 6CA excludes 'royalties' as defined in the ITAA 1936.	The parts of the definition relevant to the Ruling are now quoted at paragraph 24 of the final Ruling. We consider the parts of the definition quoted at paragraph 24 of the final Ruling deal with the first aspect and that mention of royalties is not relevant to the Ruling.
2	The draft Ruling does not define the term 'override royalties'. That term has a technical meaning in the oil/gas industry and may mean different things to different people. The final Ruling should provide further detail on the meaning of 'override royalties' (and the commercial features of override royalties) or use the term 'natural resource income'. Alternatively, the final Ruling should be more explicitly targeted at particular transaction structures which are of concern. For example, the Ruling could be redrafted as a Taxation Determination.	We consider that defining the term 'override royalties' overstates the status the term has in the Ruling. Paragraph 1 of the final Ruling explains, in broad terms, when the Ruling applies and that the term 'override royalties' is merely used for convenience. Part A (paragraphs 4 to 14) of the final Ruling explains in detail when the Ruling applies. Any specific technical or commercial meanings of the term 'override royalties' are not relevant for the purposes of the Ruling. We consider a Taxation Ruling the best product for dealing with the issues raised in the draft Ruling. The reasons for undertaking this work do not reflect concerns over particular structures.

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3	The final Ruling should include the Commissioner's view on the application of the business profits article in Australian tax treaties to 'natural resource income' and the interaction between the business profits article and the income from real property article.	We consider that this topic is beyond the scope of this Ruling. Paragraph 3 of the final Ruling confirms it does not consider articles in a tax treaty other than the real property article.
4	The final Ruling should explicitly distinguish between the grant of a right to receive an override royalty (which is not 'natural resource income' and most likely covered under capital gains tax provisions) and receiving payments under that right.	We consider that this topic is beyond the scope of this Ruling. Paragraph 3 of the final Ruling states that it does not address the tax treatment of grants, assignments or transfers of the right to receive an override royalty payment.
5	The final Ruling should elaborate on the definition of 'natural resources' in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) and that definition should be limited to naturally-occurring resources and not extend to refined metals. The inference in the draft Ruling that products made out of 'natural resources' can still be considered 'natural resources' is inconsistent with the policy intent of section 6CA. For example, the language of paragraph 10 in the draft Ruling arguably includes steel as a 'fully refined' resource. Paragraph 8 of the draft Ruling does not explain what is meant by the 'relevant state' of the resource or explain why refined metals are natural resources produced/recovered. The draft Ruling is contrary to section 6CA's focus on the extracted value of the resource, rather than the manufactured value of a refined metal.	We have accepted the suggestion for elaboration on the definition of 'natural resources' at paragraphs 10 to 12 and 30 to 31 of the final Ruling. We disagree that 'natural resources' are limited to resources that are naturally-occurring and that the words 'recovered' and 'produced' would exclude chemical/metallurgical processes from the scope of section 6CA. The inclusion of the term 'natural resources produced' in the definition of natural resource income contemplates more than just naturally-occurring resources. Accordingly, we consider that the focus of section 6CA cannot be only on extracted value. We have removed the term 'relevant state' from the final Ruling.

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6	The draft Ruling interprets the definition of 'natural resource income', and therefore section 6CA, too widely and uses the 'literal' approach to statutory interpretation. The provision should be interpreted using the 'purposive' and 'contextual' approaches including by using the relevant Explanatory Memorandum (EM) and Minister's speech. These two documents use the phrase 'directly related to' when referring to section 6CA indicating that Parliament intended the provision to be narrower than the interpretation in the draft Ruling. The draft Ruling will cause uncertainty as section 6CA will potentially apply to a number of commercial arrangements/payments that are not 'directly related to' the exploitation of Australia's natural resources (for example, shipping, insurance, marketing services, hedges and purchases of Australian resources between non-residents). An arrangement/payment will be 'directly related to' the exploitation of Australia's natural resources where the payment arises as a direct result or direct consequence of the relevant exploitation.	We disagree with this point. Paragraph 27 of the final Ruling addresses the purposive approach to statutory construction and we consider this Ruling uses this approach. We consider the interpretation of the definition in the final Ruling is consistent with the first paragraph of the Treasurer's press release, the EM, and a purposive approach. It is not based merely on particular words in these extrinsic materials. There is a close correlation between the text of section 6CA and the phrase 'based on the level of production and recovery'. There is little or no correlation between the text of section 6CA and the phrase 'directly related to'. 'By reference to' is a much wider phrase than 'directly related to'. The opening paragraph of the EM to the Taxation Laws Amendment Bill (No. 4) 1986 is (emphasis added): > The amendments proposed by this Bill will mean that, subject to the exception outlined below, income that is **directly related** to the exploitation of Australia's natural resources and that is derived by a non-resident (referred to as "natural resource income") will be subject to full Australian tax. The amendment will apply to payments of natural resource income made after 7 April 1986 and which are **based on the level of production and recovery** of natural resources after that date. The first sentence describes the aim and the second sentence describes the means by which the aim is achieved. The holders of mining rights may make a variety of payments, including payments to financiers and suppliers of shipping, marketing and insurance services. It is not, however, the character of the consideration or services provided by the recipient of the payment that determines whether section 6CA applies. Accordingly, it is not appropriate to rule payments in or out based upon their connection with particular arrangements or services.
7	The following additions or amendments should be made to the examples concerning section 6CA: • Example 2 – The example should address the potential Division 974 (of the ITAA 1997) issue. • Example 2 - The example should provide examples of	We disagree with the suggestion of addressing potential Division 974 of the ITAA 1997 issues in Example 2. Division 974 is outside the intended scope of this Ruling and addressing it would greatly add to the length and complexity of this Ruling. It is not considered necessary to outline types of wastage that may occur in either Example 2 or paragraph 6 of the final Ruling.

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	the types of wastage referred to in second dot point in paragraph 6 of the draft Ruling (alternatively those examples could be included in paragraph 6 itself). • Example 3 – The example should state that the reason that section 6CA does not apply is that the payment is not 'directly related' to the exploitation of Australia's natural resources. • Example 4 – The example should be changed or removed as alumina and aluminium do not occur in nature and therefore cannot be categorised as a 'natural resource' (chemical reactions are required to produce pure aluminium from alumina, which itself is produced from naturally-occurring bauxite). • Further additional examples suggested on: - sale of coal at spot price - override royalties calculated by reference to sale proceeds are not natural resources income - marketing services, and - hedging arrangements.	Former Examples 3 and 4 in the draft Ruling have been removed. We reject the submission that pure aluminium cannot be a natural resource. It is not considered necessary to add additional examples covering the suggested scenarios. Rather than having examples covering hypothetical scenarios, it is considered better to limit the examples to scenarios that we have actually seen and considered in the past.
8	Part B of the final Ruling should discuss the consequences of the real property article of tax treaties applying including that that article does not contain a separate taxing power but instead only (places) limits on each country's tax laws.	The purpose of paragraph 32 in Part B in the final Ruling is just to consider when an override royalty might be dealt with by Article 6. The normal consequences of the article applying to a payment will follow. The interaction between tax treaties and domestic law is dealt with in other ATO products, such as Taxation Ruling TR 2001/13 *Income tax: Interpreting Australia's Double Tax Agreements*. As a result, we consider it is not necessary to deal in detail with such matters in the final Ruling.
9	The draft Ruling interprets the term 'in respect of' in the real property article of Australia's tax treaties too widely. The preceding words 'as consideration for' should restrict the words 'in respect of' in the real property article. The words 'as consideration for' must have a role to play and if the words 'in	We consider we have interpreted the term 'in respect of' correctly. Those words have generally been interpreted widely by the courts. As outlined at paragraph 47 of the final Ruling, the Explanatory Memorandum to the International Tax Agreements Amendment Bill 1999, which introduced the first Amending protocol to the Malaysian treaty into Australian law, explains that the

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	respect of' are interpreted widely it will make 'as consideration for' superfluous. As such, the phrase 'either as consideration for or in respect of' should be interpreted to be a two-limbed test that only covers rights to payment which are either: 1. 'consideration for … the exploitation of, or the right to explore for or exploit…' natural resources deposits, etcetera, or 2. Not in consideration for anything but 'in respect of the exploitation of, or the right to explore for or exploit…' natural resources deposits, etcetera. Therefore, if a payment is consideration for anything, it can only be caught by the real property article if it is consideration for '…the exploitation of, or the right to explore for or exploit…' natural resources deposits, etcetera.	income from real property article is intended to include payments that are natural resource income under section 6CA and that the words 'or in respect of' were introduced for this purpose. As per that Explanatory Memorandum: 2.25 The inclusion of the words 'or in respect of' in relation to natural resources are intended to ensure that Australia may tax payments which are 'natural resource income' for Australian tax purposes. 2.26 Natural resource income includes payments which, unlike royalties, are based on a contractual arrangement and not on the holding of any proprietary right in the natural resources concerned. The inclusion of the words 'or in respect of' therefore ensures that the definition of land includes not only payments in consideration for *the right* to exploit or to explore for natural resources, but also payments in relation to those resources where there is no proprietary right to explore/exploit the resources concerned. As such, it is considered inappropriate to give a narrow and restrictive meaning to the words 'in respect of'.
10	The words 'in respect of' require that there be a direct connection between the payments under the override royalty arrangement and the exploitation of the relevant natural resources. This connection needs to be more direct than the payment being calculated 'by reference to' the value of the natural resources. The nexus requires that the payment have a connection with the natural resources deposit in that the payment arises from an involvement by the payee with the exploitation process (for example, as a geologist or mining engineer). Paragraph 44 of the draft Ruling needs to be clarified so as to limit the scope of the real property article to instances where the relevant payer is the entity exploiting the right. The real property article should exclude instances where there is no right to income granted but where the holder of a tenement and another party refer to minerals exploited to calculate an amount payable by the tenement holder.	We consider it is inappropriate to read an activity test into the real property article. Whether or not a payment is 'in respect of' the exploitation of a natural resource is not dependent on activities performed by the recipient. Such an interpretation would exclude passive receipt of such income from the real property article. Nor is it appropriate to limit the scope of the real property article to only include payments made by the entity exploiting the relevant natural resource. We consider that changes to the final Ruling based on the points raised are not appropriate.

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11	The Netherlands Agreement[1] does not fall into the 'general position for tax treaties' (paragraph 14 to 15 of the draft Ruling) and is not mentioned as an exception in footnote 4 of the draft Ruling.	We consider the Netherlands Agreement falls within the general position mentioned in paragraphs 16 and 17 of the final Ruling as Article 6 of the Netherlands Agreement includes '…other payments in respect of …the exploitation of any natural resource…'
12	The final Ruling should address other issues with section 12-325 of Schedule 1 to the *Taxation Administration Act 1953*, such as how the rate of withholding is determined.	We consider that this topic is outside the scope of the Ruling.

[1] *Agreement between Australia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Protocol* [1976] ATS 24.