TR 2017/D11 - Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data

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Draft Taxation Ruling

Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data

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Summary – what this ruling is about

1. This draft Ruling considers how the capital allowance provisions in Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] apply to the expenditure incurred by a service provider (you) in collecting and processing seismic data licensed on a non-exclusive basis to multiple clients.[2]

2. In particular, this draft Ruling considers:

- the nature of the expenditure you incur
- whether the seismic data is trading stock
- whether the seismic data is a CGT asset
- whether the seismic data is a depreciating asset that you hold
- the effective life of the seismic data, and whether its cost is deductible under section 40-80

[1] All legislative references are to the ITAA 1997 unless otherwise specified.
[2] This Ruling does not apply to you if, under the terms of the relevant contracts or agreements, you provide contract seismic services exclusively to a single client (or a joint venture operator acting on behalf of the joint venture's participants) that directs the scope and extent of the seismic survey and becomes the owner of the seismic data created.

- whether the expenditure you incur is deductible under subsection 40-730(1)
- circumstances in which balancing adjustment events may occur for the seismic data, and
- expenditure excluded from the scope of this draft Ruling.

Ruling

3. The expenditure referred to in paragraph 1 of this draft Ruling is capital in nature, and you cannot deduct it under section 8-1.[3] This includes:

- labour costs you incur in creating or augmenting the data
- leave payments covered by paragraphs 26-10(1)(a) or (b), and
- repairs and maintenance.

However, there are some exceptions, listed at paragraph 11 of this draft Ruling.

4. Seismic data is mining, quarrying or prospecting information (MQPI) as defined in subsection 40-730(8). It is neither trading stock, nor is it a capital gains tax (CGT) asset. It is a depreciating asset as defined in paragraph 40-30(2)(b).

5. For the purposes of identifying 'the depreciating asset', we consider that the entirety of your data library is a composite item which is not itself a depreciating asset. However, it is capable of dissection into separate identifiable components, each of which has commercial or economic value in itself, and is a depreciating asset.[4] Each component has its own attributes relevant to Division 40. These include:

- its start time
- its cost
- the period you hold it, and
- whether a balancing adjustment event occurs in relation to it, and so on.

[3] Paragraph 8-1(2)(a).
[4] See subsection 40-30(4).

There may also be circumstances in which you may split one of these components into other components, or merge it with another component. [5] [6]

6. The cost of the data for the purposes of Subdivision 40-C is the expenditure you incur to create it. You can deduct the decline in value of the data under subsection 40-25(1) to the extent that you hold the data under section 40-40.

7. You work out the decline in value using either the diminishing value method or prime cost method. Section 40-80 does not apply to treat the decline in value of the data as its cost for the purposes of subsection 40-25(1). Nor does subsection 40-730(1) apply to allow you an immediate deduction for the expenditure.

8. The decline in value is calculated using an effective life of 15 years, as determined under subsection 40-95(12).

9. You should apportion items of expenditure not wholly attributable to a particular depreciating asset on a fair and reasonable basis.[7]

10. A balancing adjustment event occurs for the data if you stop holding it.[8] This happens, for example, if you sell the data or it becomes generally available. Other circumstances in which a balancing adjustment might occur are where:

- you stop using the data for any purpose, and expect never to use it again[9]
- you have not used the data and decide never to use it[10], or
- there is a change in the entity or entities that hold, or have an interest in, the data, involving the formation, change or dissolution of a partnership, provided at least one entity has a continuing interest before and after the change.[11]

Exceptions

11. Interest on borrowings to finance the collection and processing of the data is excluded from the scope of this draft Ruling,

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[5] For the consequences of the split or merge, see sections 40-115 and 40-125 respectively. The cost of the resulting components or component is worked out under sections 40-205 and 40-210 respectively.
[6] See Appendix 2 of this draft Ruling for practical guidance on the issues raised in this paragraph.
[7] See *Ronpibon Tin NL v. FCT* (1949) 78 CLR 47 at 49.
[8] Paragraph 40-295(1)(a).
[9] Paragraph 40-295(1)(b).
[10] Paragraph 40-295(1)(c).
[11] Subsection 40-295(2). However, a mere splitting of the data into two or more depreciating assets, or merging it with other depreciating assets, does not give rise to a balancing adjustment event: subsection 40-295(3).

to the extent the interest is a revenue expense.[12, 13] The following are also excluded from the scope of this draft Ruling:[14]

- borrowing expenses deductible under section 25-25
- a loss or outgoing to which section 25-90 applies
- a loss from a financial arrangement to which Division 230 applies that is deductible under subsection 230-15(2) or (3)
- contributions you make, as an employer, to a superannuation fund or a retirement savings account (RSA) that are deductible under Subdivision 290-B
- a forex realisation loss deductible under section 775-30, and
- capital expenditure to terminate a lease or licence that is deductible under section 25-110.

Example

12. *Big Bang Seismic Co (BBSC), a company incorporated in Australia, carries on a business of collecting and processing offshore seismic data and licensing the data to clients in the oil and gas industry. The areas BBSC surveys may be in vacant acreage or acreage that is held under title.*

13. *BBSC undertakes a seismic survey of an area and processes the survey data. Typical expenses it incurs in carrying out these activities include:*

- *vessel lease*
- *maritime crew hire*
- *support vessel hire*
- *technical and support crew hire*
- *travel costs for crew and subcontractors*
- *fuel, food and consumables*
- *equipment and software hire*
- *data processing costs*
- *repairs and maintenance*
- *costs of external on-board contractors such as medics, environmental supervisors and fishing liaison officers, and*

[12] See *Steele v. FC of T* 99 ATC 4242 at 4248 to 4249; (1999) 41 ATR 139 at 148.
[13] See section 40-220.
[14] See section 40-215.

- *an apportionment of administration, interest and borrowing expenses.*

14. *BBSC enters into non-exclusive licensing arrangements with multiple clients who wish to evaluate accumulations of oil and gas reserves. BBSC licenses sections of its seismic data for an extended period, typically 25 years, in return for licence fees. The fees may be payable upfront or in specified instalments, depending on the contract. BBSC retains ownership of the copyright and other intellectual property in the seismic data and can deal with it in whatever way they wish. The seismic data is proprietary to, and a trade secret of, BBSC. If, during the licence period, a licensee obtains a title (or interest in a title) within the survey area permitting the licensee to extract oil or gas, it must pay BBSC additional fees.*

15. *Licensees may use the licensed seismic data only for their own purposes and benefit, and may not copy, sell or transfer it to third parties, except as BBSC expressly allows. When the licence expires or terminates, the licensees must return or destroy any copies of the data in their possession.*

16. *BBSC incorporates the expenditure mentioned in paragraph 13 of this draft Ruling into the cost of the data for the purposes of Subdivision 40-C. However, the amount of apportioned interest is not of a capital nature, and section 40-220 reduces the cost of the data by that amount. Each element of the cost is also reduced, under section 40-215, by the amount of the section 25-25 deductible borrowing expenses attributable to that element. BBSC can deduct an amount for the decline in value of the data under section 40-25.*

17. *The decline in value is calculated using an effective life of 15 years as determined under subsection 40-95(12).*

Date of effect

18. When the final Ruling is issued, it is proposed to apply both before and after its date of issue.

19. However, paragraphs 8 and 17 of the Ruling will not apply to taxpayers in relation to seismic data that they started to hold:

(a) before 7:30pm Australian Eastern Standard Time on 14 May 2013, or

(b) through exercising a right to acquire the data which right they held continuously since immediately before the time in paragraph 19(a) and where the terms and conditions for exercising the right (including the consideration given or to be given for the right) were agreed before that time.

20. The Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
20 December 2017

Appendix 1 – Explanation

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

Expenditure is of a capital nature

21. The characterisation of the expenditure by the service provider as revenue or capital is fundamental to its treatment. Exploration or prospecting[15] expenditure is not automatically capital in nature. Rather, it is a question of fact in each case whether it is capital or revenue.[16]

22. The distinction between capital and revenue 'corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay'.[17] To determine the nature of an outgoing, the whole set of circumstances of the commercial context within which the expenditure is made must be taken into account.[18] This requires 'both a wide survey and an exact scrutiny of the taxpayer's activities.'[19] The answer 'depends on what the expenditure is calculated to effect from a practical and business point of view.'[20]

23. In other words, the character of the expenditure is chiefly determined by the character of the advantage you seek by making it. This is usually 'determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure.'[21] Expenditure made once and for all with the intention of creating an asset or an advantage for the enduring benefit of a trade is usually capital in nature.[22]

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[15] The term 'exploration or prospecting' is defined inclusively in subsection 40-730(4) and includes geophysical surveys.
[16] *Commissioner of Taxation v. Ampol Exploration Ltd* (1986) 13 FCR 545 at 562; 86 ATC 4859 at 4872; (1986) 18 ATR 102 at 119; (1986) 69 ALR 289 at 307.
[17] *Sun Newspapers & Anor v. Federal Commissioner of Taxation* (1938) 61 CLR 337 at 359, per Dixon J.
[18] *BP Australia Ltd v. Commissioner of Taxation of the Commonwealth of Australia* (1965) 112 CLR 386 at 397; *AusNet Transmission Group Pty Ltd v. Federal Commissioner of Taxation* [2015] HCA 25 at [74]; 2015 ATC 20-521 at [74].
[19] *Western Gold Mines (NL) v. Commissioner of Taxation (WA)* (1938) 59 CLR 729 at 740, per Dixon and Evatt JJ.
[20] *Hallstroms Pty Ltd v. Federal Commissioner of Taxation* (1946) 72 CLR 634 at 648, per Dixon J.
[21] *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124 at 137; [1990] HCA 25 at [13]; 90 ATC 4413 at 4419, per Brennan, Dawson, Toohey, Gaudron and McHugh JJ. See also *Colonial Mutual Life Assurance Society Ltd v. Federal Commissioner of Taxation* (1953) 89 CLR 428 at 454, per Fullagar J.
[22] *British Insulated and Helsby Cables Ltd v. Atherton* [1926] AC 205 at 213 to 214, per Viscount Cave. Note that the converse is not necessarily the case: see *John Fairfax & Sons Pty Ltd v. Federal Commissioner of Taxation* (1959) 101 CLR 30 at 36, per Dixon CJ.

24. From a practical and business point of view, you incur the expenditure to create or add to a library of seismic data to be licensed for profit to your clients. The data is an asset of value to you, as it is protected by your licensing agreements, including the non-disclosure clauses, and you exploit it by deriving income in the form of licence fees.

25. Further, it is an asset from which you derive an enduring benefit, as evidenced by the length of the licensing agreement terms negotiated: typically 25 years. It is of central importance to your business and an inextricable part of the 'structure or organization set up or established for the earning of profit'.

26. The data is a capital asset, and your expenditure on creating and adding to is accordingly capital in nature. This includes any labour costs associated with these activities. [23] [24] Therefore, the expenditure is not deductible under section 8-1 because of paragraph 8-1(2)(a).

Seismic data is not trading stock

27. Under section 70-25, outgoings connected with acquiring trading stock are not capital in nature. Subsection 70-10(1) relevantly defines 'trading stock' to include anything produced, manufactured or acquired that is held for the purposes of manufacture, sale or exchange in the ordinary course of a business.

28. This definition 'presupposes that the person by whom [goods] are produced, manufactured, acquired or purchased is or will be engaged in trade in those goods.'[25] The terms 'sale' and 'exchange' in the expression 'sale or exchange in the ordinary course of a business' refer to trading activity in which ownership of the thing traded passes.

29. By contrast, you retain ownership of the copyright and other intellectual property in the seismic data, which is proprietary to you and is a trade secret of yours. You do not 'trade' in the seismic data you created by passing ownership of it to your clients. Therefore, it is not trading stock. [26]

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[23] See *Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation* (1991) 29 FCR 376; 91 ATC 4438; (1991) 22 ATR 26 and *Federal Commissioner of Taxation v. Star City Pty Limited* (2009) 175 FCR 39; [2009] FCAFC 19; 2009 ATC 20-093; (2009) 72 ATR 431.

[24] This view is consistent with the Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014 at paragraph 1.28.

[25] *John v. Federal Commissioner of Taxation* (1989) 166 CLR 417; [1989] HCA 5; 89 ATC 4101; (1989) 20 ATR 1.

[26] Subsection 70-10(2) merely restricts what is trading stock and does not change this conclusion.

30. Accordingly, section 70-25 does not preclude the expenditure from being capital in nature. Consequently, the expenditure is neither deductible under section 8-1, nor excluded from the cost of the data under section 40-215.

Seismic data is not a CGT asset

31. Subsection 108-5(1) defines a CGT asset as 'any kind of property or a legal or equitable right that is not property'. Taxation Determination TD 2000/33 *Income tax: capital gains: is know-how a CGT asset?* states that know-how is knowledge or information which is not a CGT asset because it is neither a form of property nor a legal or equitable right.

32. The same is true of the seismic data.[27]

Seismic data is a depreciating asset

33. You can deduct the decline in value for a 'depreciating asset' that you hold during the year.[28] Relevantly, MQPI that is not trading stock is a depreciating asset.[29]

34. The seismic data that you collect and process is geological, geophysical or technical information that relates to, or is likely to help in determining, the presence, absence or extent of deposits of minerals in an area. It is therefore MQPI as defined.[30] Since it is not your trading stock, the seismic data is a depreciating asset.

When you 'hold' the seismic data

35. The table in section 40-40 sets out who holds a depreciating asset. Relevantly, items 8 and 9 of the table deal with who holds MQPI. Item 8 applies to MQPI that an entity has, whether or not it is generally available, that is relevant to:

- mining and quarrying operations carried on, or proposed to be carried on, by the entity, or
- a business carried on by the entity that includes exploration or prospecting for minerals or quarry materials obtainable by such operations.

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[27] See also *Federal Commissioner of Taxation v. United Aircraft Corporation* (1943) 68 CLR 525 at 534; *Brent v. Federal Commissioner of Taxation* (1971) 125 CLR 418 at 425; 71 ATC 4195 at 4198.

[28] Subsection 40-25(1).

[29] MQPI is one of several categories of intangible assets that are expressly included by subsection 40-30(2) as depreciating assets if they are not trading stock. All other intangible assets are excluded from the definition of 'depreciating asset' under subsection 40-30(1).

[30] The definition is in subsection 40-730(8). The meaning of 'minerals' used in that definition is extended by subsection 40-730(5) to include 'petroleum', itself a term defined in subsection 40-730(6).

Item 9 applies to other MQPI that an entity has that is not generally available.

36. Once you have conducted a seismic survey of an area, you have the relevant MQPI through possession, ownership and use of the data. However, item 8 does not apply to the MQPI because you do not carry on the type of operations or business mentioned in that item. You therefore hold the MQPI under item 9 while it is not generally available.

37. Once the data becomes generally available, you cease to hold the MQPI under table item 9 in section 40-40 and a balancing adjustment event occurs for that data under paragraph 40-295(1)(a).[31]

Effective life of seismic data

38. Where an entity has MQPI and is not engaged in mining and quarrying operations, the MQPI will not relate to an actual or proposed mine, petroleum field or quarry. In that circumstance, the effective life of the MQPI is 15 years.[32] The entity may not self-assess the effective life of the MQPI.[33]

39. As you are not engaged in mining and quarrying operations, the effective life of a depreciating asset you hold that is seismic data is 15 years. You must use this effective life when you calculate the decline in value of the data for the relevant income year under whichever method you choose.[34]

40. You may not immediately deduct the cost of the data because section 40-80 does not apply to you. This is explained below.

Section 40-80 does not apply to the seismic data

41. Under section 40-80, the decline in value of a depreciating asset is its cost if you first use the asset for 'exploration or prospecting' for 'minerals', or quarry materials, obtainable by 'mining and quarrying operations'[35], subject to the other requirements of that section.

42. However, you do not satisfy the 'first use' requirement because your activities consist of gathering the MQPI for others to use. You do not use the MQPI in your own right for exploration or prospecting for minerals, etcetera obtainable by mining and quarrying operations.

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[31] See paragraph 10 of this draft Ruling for other circumstances in which a balancing adjustment event occurs for the data.
[32] Subsection 40-95(12).
[33] Paragraph 40-105(4)(c).
[34] You make the choice under section 40-65 between the diminishing value method (see section 40-70 or 40-72) or the prime cost method (see section 40-75).
[35] Paragraph 40-80(1)(a).

43. Moreover, one of the other requirements referred to in paragraph 41 of this draft Ruling, set out in paragraph 40-80(1)(c), is that at the asset's start time, you must:

- carry on mining and quarrying operations,[36] or it would be reasonable to conclude you proposed to do so[37], or
- carry on a business of, or that includes, exploration or prospecting for minerals or quarry materials obtainable by such operations, and expenditure on the asset was necessarily incurred in carrying on that business.[38]

44. You do not satisfy the first of these conditions.

45. As for the second condition, although one of the activities listed in the definition of 'exploration or prospecting' is 'geophysical surveys'[39], it does not follow from this that you carry on a business of exploration or prospecting. Your business is a provider of geophysical surveys on behalf of, or for the benefit of, others.

46. The basis of the concessional treatment of exploration or prospecting expenditure is the inherent uncertainty and economic risk involved in obtaining rewards from the exploitation of the results (minerals) discovered through conducting the exploration or prospecting activities. While there is no guarantee that your activities will find any mineral deposits, or that they will be commercially exploitable, your clients bear that economic risk, not you. Your risk is that you will not be able to cover the costs of undertaking a survey from licensing the resulting data.

47. You would typically mitigate this risk by securing pre-funding or pre-commitments for all, or a majority, of the costs of the survey before making an investment decision to proceed with the survey. In this respect, your risk-reward profile is unlike that of a miner, or even that of a so-called 'junior explorer'.[40]

48. Therefore, we consider that you do not satisfy the second condition in paragraph 43 of this draft Ruling either. Since the conditions in section 40-80 are not met, it does not apply.

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[36] Subparagraph 40-80(1)(c)(i).
[37] Subparagraph 40-80(1)(c)(ii).
[38] Subparagraph 40-80(1)(c)(iii).
[39] Subsection 40-730(4).
[40] A junior explorer who explores or prospects for new mineral discoveries may market those discoveries to larger players. It may do so by diluting its interest in any potential discovery rather than exclusively bearing the burden of developing or exploiting whatever it finds itself.

No deduction under subsection 40-730(1)

49. Subsection 40-730(1) allows you to deduct expenditure incurred in an income year on exploration or prospecting for minerals, or quarry materials, obtainable by mining and quarrying operations, subject to conditions which are for all practical purposes identical to those set out in paragraph 40-80(1)(c) (see paragraph 43 of this draft Ruling). Those conditions are not satisfied in your circumstances (see paragraphs 44 to 48 of this draft Ruling), and so neither are the conditions in subsection 40-730(1).

50. In addition, subsection 40-730(3) prevents you from deducting expenditure under subsection 40-730(1) to the extent it forms part of the cost of a depreciating asset. Your expenditure incurred in collecting and processing seismic data does form part of the cost of a depreciating asset (see paragraphs 33 and 34 of this draft Ruling), so subsection 40-730(3) would prevent a deduction of the expenditure under subsection 40-730(1) in any event.

Date of effect and amendments to treatment of effective life of MQPI

51. The limitations on the retrospective effect of this draft Ruling set out in paragraph 19 correspond with the application provisions in item 16 of Schedule 1 to the *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Act 2014* (the Amendment Act). Section 3 and Schedule 1 of the Amendment Act introduced a number of amendments to Division 40. These included amendments to sections 40-95, 40-105 and 40-110 (the rules for choosing, self-assessing and recalculating the effective life of depreciating assets respectively) and in particular, the introduction of subsection 40-95(12) and paragraph 40-105(4)(c) dealing with MQPI.

Appendix 2 – Compliance approach

This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this appendix in good faith and consistently with the ruling section, the Commissioner will administer the law in accordance with this approach.

Identifying the asset

52. In practically applying Division 40 to seismic data that you license to multiple clients, you need to determine the exact depreciating asset that is being considered. For example, when working out the start time for the data under section 40-60, or determining if a balancing adjustment event happens to the data under section 40-295, it is essential to know what data is under consideration. You will need to determine this considering the practicalities of your industry.

53. As an illustration: if you are an offshore seismic service provider, it would not be practicable to consider your entire data library, perhaps covering thousands of square kilometres of seabed, as a single undifferentiated depreciating asset. Practically, the library would consist of a number of components ('data components'), each one a separate depreciating asset, with its own first and second element of cost, start time, adjustable value and other attributes relevant for Division 40 purposes.

54. While it may sometimes be the case that all of the data you collect in a particular survey can be treated as a single asset because it provides a coherent package of information, it may be necessary in practice to break it down further. Generally, you would be granted a permit to survey a particular set of blocks, each block being all or part of a graticular section.[41] You would then use your best efforts to license the data from the surveyed blocks to interested parties. Depending on the practicalities of this process, a single data component might consist of the survey data from an individual block or a combination of two or more blocks. We will accept any such delineation of the data that makes practical sense in your circumstances, having regard to your natural systems.[42] We would, however, expect you to be consistent in your approach.

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[41] The terminology may vary by jurisdiction. Onshore in Western Australia (for example), a graticular section is an area bounded by lines of latitude and longitude one minute apart, and a block is a graticular section that is wholly within the State or otherwise that part of a graticular section that is within the State (see section 56C of the *Mining Act 1978* (WA)). In Queensland, a block is an area bounded by lines of latitude and longitude five minutes apart, each being divided into 25 sub-blocks one minute of latitude by one minute of longitude (see section 126 of the *Mineral Resources Act 1989* (Qld)). Offshore in Commonwealth waters, a graticular section is an area bounded by lines of latitude and longitude five minutes apart, and a block is a graticular section that is wholly or partly within an offshore area

Timing and the asset's use

55. The start time of each data component is when you first 'use' it.[43] In practice, this would be when a copy of the data component is first delivered under the earliest licence agreement entered into for that data component. This is the moment following creation of the MQPI when you first use the data to meet your obligations as a licensor under the licensing agreement. The processing and analysis of the raw data would have had to be completed to a standard required under the licence agreement before this 'use' takes place.

56. The data component stops being used at the earliest time when there is no longer a licence agreement that covers it, providing that the data component is not put to any other use. If, at this time, you expect never to license the data component again, or otherwise use it for any purpose, a balancing adjustment event happens.[44]

57. To provide evidence for the balancing adjustment being triggered at this time, you can refer to the governance processes, policies and procedures of your business. For example: an evidence-based decision by the board of directors or relevant personnel about the prospects and viability of any future licensing or other use of the data component.

58. As with any commercial decision, we expect you to demonstrate that you have considered contemporaneous and corroborative bases. These should include, but are not limited to, a combination of the following:

- the currency and quality of the data component's content
- any comparative advantage that you have in producing the data component
- the level and results (if known) of activities (whether seismic or drilling) being undertaken in surrounding blocks or areas of interest
- results of recent marketing efforts for the data component and feedback from potential target customers

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(see section 33 of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (Cth)).

[42] For example, the accounting, project budgeting and cost management systems typically used might be able to handle the delineation of the data on a block-by-block basis for the purposes of Division 40. This fact would be further supported if it is demonstrable that commercial licensing decisions are also made on a block-by-block basis.

[43] Subsection 40-60(2).

[44] See paragraph 10 of this draft Ruling for other circumstances in which a balancing adjustment event can occur.

- geological assessment and recommendation by experts of the ongoing utility and commercial viability of the data (the experts must have the necessary experience and credentials, but may be internal or external to your business)
- cost-benefit analysis, including the assessment of business case, budget allocations and returns on investment, of any potential further licensing prospects or the ongoing marketing or reprocessing of the data
- consideration of the impact of recent and current or upcoming government acreage release trends, including publications of geoscience data, information and advice provided by governments and associated authorities on mineral resources and resource potential in a relevant area, and
- consideration of applicable industry trends, including recent known title and acreage bids, awards or gazettals, work programs and other dealings and transactions.

We will generally not seek to disturb outcomes that are supported by contemporaneous documentation and evidence of the kind listed above.

59. Where you have previously triggered a balancing adjustment for a data component because you stopped using it, expecting never to use it again, but you later reprocess, sell or license it, you start using it again. When this happens, there is a second start time for the data component.[45] From that point, you will need to account for the Division 40 consequences, including resetting its cost and adjustable value[46], and recognising a further gain or loss when another balancing adjustment event occurs.

[45] Subsection 40-60(3); paragraph 40-295(1)(b).
[46] Subsection 40-285(4) and subsection 40-180(2), items 3 and 4 in the table.

Splitting and merging data

60. If at any time it becomes practically necessary to split a data component you hold, Division 40 applies as if you had stopped holding the original data component, and started holding the split data components.[47] Splitting a data component does not in itself give rise to a balancing adjustment event.[48] If you stop holding part of a data component, Division 40 applies as if, just before you stopped holding that part, you had split the original data component into the part you stopped holding and the rest of the original data component. These are both now treated as different assets from the original data component.[49] The cost of the data components arising from the split is worked out under section 40-205.

61. Similarly, if at any time it becomes practically necessary to merge a data component with another, Division 40 applies as if you had stopped holding the original data components and started holding the merged one.[50] As with splitting, the merging does not in itself give rise to a balancing adjustment event.[51] The cost of the merged data component is worked out under section 40-210.

Resurveying an area

62. If you resurvey an area you have already surveyed, you must consider whether the new survey gives rise to a new data component (depreciating asset) for the area, or an improvement to the data component you already hold for the area. In the latter case, the cost of the improvement forms part of the second element of the cost of the existing data component.[52]

63. The question is one of fact and degree. In the case of a resurvey that accomplishes only minor improvements in the quality of data or coverage, or that reveals little or no change in the survey area or the survey findings, no new data component comes into being. On the other hand, a new data component is created where you undertake a resurvey that employs newer technology resulting in one or more of:

- a substantial improvement in the quality or quantity of the data
- the acquisition of completely new data, or

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[47] Subsection 40-115(1).
[48] Subsection 40-295(3).
[49] Subsection 40-115(2).
[50] Section 40-125.
[51] Subsection 40-295(3).
[52] See section 40-190. If the new survey results in the creation of more than one new data component, or the improvement of more than one existing data component, the costs of the survey will need to be apportioned across the first or second elements (respectively) of the costs of the data components. See also paragraph 9 of this draft Ruling.

- the revelation of substantial changes in the area since the previous survey.

An example is a new 3-D survey that replaces an earlier 2-D survey.[53]

Record Keeping

64. You should produce and maintain contemporaneous records and documentation on each data component in your library, as for any other depreciating asset. The documentation should include:

- what the asset is
- when you started to hold it, or started to hold it again (if applicable)
- when you ceased to hold it (if applicable)
- when its start time was, or when another start time occurs (if applicable)
- its cost, including the first and second elements
- what method you used to work out the decline in value of the asset
- the details of any balancing adjustment events that happened to the asset
- the details of any split or merger and what asset or assets resulted, along with the requisite cost adjustments.

[53] Indicia of improvements can be further gleaned from paragraphs 44 to 54 of Taxation Ruling TR 97/23 *Income tax: deductions for repairs*, though will necessarily need to be adapted to the context and characteristics of seismic data and the seismic industry.

Appendix 3 – 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.

65. It has been submitted to us that in many instances, service providers incur the expenditure on revenue account when undertaking multi-client surveys.[54] The expenditure, therefore, should be deductible under section 8-1. (We refer to this as 'the revenue argument' below).

Capital / revenue cases cited in favour of revenue argument

66. Proponents of the revenue argument cite, in particular, three cases in support of their view:

- *BP Australia Ltd v. Commissioner of Taxation of the Commonwealth of Australia*[55]
- *National Australia Bank v. Commissioner of Taxation*[56]*,* and
- *Commissioner of Taxation v. Ampol Exploration Ltd*[57].

67. Further, they argue, *Goodman Fielder Wattie v. Federal Commissioner of Taxation*[58] supports their view that expenditure on employee remuneration for survey work is revenue in nature.[59]

68. In our view, all of these cases are distinguishable on their particular facts and on the characterisation of those facts by the courts in applying established legal principles. As we explain below, the decisions in those cases do not compel a similar conclusion in the circumstances considered in this draft Ruling.

69. The background to *BP Australia* was that in the early 1950s, the arrangements for selling petrol changed from a model in which each service station sold multiple brands to one in which the service station was tied to a particular supplier and sold only its brand. In line with this trend, BP Australia offered inducements to retailers to sell only BP petrol.

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[54] Contrary to our view as stated in paragraph 3 of this draft Ruling.
[55] [1965] 3 All ER 209; (1966) AC 224; (1965) 112 CLR 386.
[56] [1997] FCA 1934; 97 ATC 5153; 37 ATR 378.
[57] (1986) 13 FCR 545; 86 ATC 4859; (1986) 18 ATR 102; (1986) 69 ALR 289.
[58] (1991) 29 FCR 376; [1991] FCA 264; 91 ATC 4438.
[59] Contrary to the first two dot points in paragraph 3 of this draft Ruling.

70. In considering whether these payments were on revenue or capital account, the Privy Council found that 'the advantage which BP sought was to promote sales and obtain orders for petrol by up-to-date marketing methods, the only methods which would now prevail.'[60] In the circumstances, the only way for BP to do this was through tied retailers. 'Its real object however was not the tie but the orders that would flow from the tie', said the Privy Council.[61] The inducement payments 'became part of the regular conduct of the business' and 'one of the current necessities of the trade.'[62] These facts, the Privy Council concluded, pointed to the expenditure being on revenue account.

71. In *National Australia Bank*, the question at issue was whether the taxpayer was entitled to a deduction under subsection 51(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) for $42 million paid to the Commonwealth for a 15 year exclusive right to be the lender for the housing loan assistance scheme for Australian Defence Force (ADF) personnel.

72. The Full Federal Court held that from a practical and business point of view, the advantage the Bank sought in making the payment was to expand its home loan customer base and to earn income. The payment was found to be on revenue account, despite being a one-off payment, because it:

- was in the nature of a marketing expense (not unlike a loan referral commission)
- did not enlarge the framework within which the Bank carried on its ordinary activities of borrowing and lending money, and
- was expected to be recouped out of profits made from the loans and other products sold to the ADF personnel.

73. In *Ampol Exploration Ltd*, the taxpayer, the exploration arm of Ampol, was invited by the Chinese Government, along with other participants, to carry out a geophysical survey off the Chinese mainland. This would entitle the participants, who would share the survey costs, to bid for exploration and development work. Ampol Exploration assigned its rights under this and related agreements to a company in which it was the majority shareholder in return for a fee.

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[60] (1965) 112 CLR 386 at 398.
[61] Ibid at 398.
[62] Ibid at 398.

74. The Full Federal Court held by majority that Ampol's share of the survey expenditure was deductible under subsection 51(1) of the ITAA 1936. On the capital / revenue question, the court concluded that 'the payments in question were in truth part of the outgoings of the taxpayer in the course of carrying on its ordinary business activities'[63] and so were on revenue account. The expenditure was not incurred for the purpose of enlarging a business structure or a profit-yielding or income-producing asset.

Distinguishing features

75. By contrast with *BP Australia* and *National Australia Bank*, the expenditure referred to in paragraph 1 of this draft Ruling is not directed towards marketing the service provider's product, that is, the seismic data. Nor is it in the nature of an inducement or marketing payment. For this reason, those cases cannot be relied on to establish that the expenditure is on revenue account.

76. In *Ampol Exploration Ltd*, as Burchett J pointed out, the taxpayer was an oil exploration company and all of its activities were directed to the finding and commercial exploitation of undiscovered oil.[64] It was on this basis that he concluded that Ampol's expenditure was an ordinary incident of the company's operations. By contrast, a service provider does not seek to commercially exploit whatever mineral deposits its data might reveal. For this reason, *Ampol Exploration Ltd* also cannot be relied on to establish that the expenditure referred to in paragraph 1 of this draft Ruling is on revenue account.

77. Despite his finding in *Goodman Fielder Wattie*, Hill J noted that the question of whether the salary and wages were on capital or revenue account was one of fact and degree. He said that 'where a person is employed for the specific purpose of carrying out an affair of capital, the mere fact that that a person is remunerated by a form of periodical outgoing would not make the salary or wages on revenue account.'[65] Therefore, this case also does not assist the proponents of the revenue argument.

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[63] (1986) 13 FCR 545 at 562; 86 ATC 4859 at 4872; (1986) 69 ALR 289 at 307, per Lockhart J.
[64] Ibid, FCR at 574 to 575; ATC at 4882.
[65] (1991) 29 FCR 376 [92]; [1991] FCA 264 at 44; 91 ATC 4438 at 4453.

78. The service provider, in carrying out its surveys, builds up a library of proprietary seismic data. This is a capital asset, as the survey provider licenses the data for fees, and on terms that prevent ownership or control passing to the licensees. Expenditure on the seismic surveys is essential to creating the survey data assets. This is capital expenditure. The fact that the service provider regularly or repeatedly incurs expenditure on new surveys is not decisive.[66]

Arguments citing conflicts with other ATO rulings

79. It has been further argued that the nature of a service provider's business model is not dissimilar to that of software licence providers as discussed in Taxation Ruling TR 93/12 *Income tax: computer software*. Among other matters, this draft Ruling deals with whether the software is trading stock for a developer who licenses its use.

80. In particular, it states (at paragraph 7) that where software is produced or developed for licence rather than for sale and the developer or supplier carries on a business of trading in software licences, the licences are considered to be trading stock. As the Ruling makes clear at paragraph 50, this position is adopted typically for software distributors on the basis of the High Court's decision in *Federal Commissioner of Taxation v. Suttons Motors (Chullora) Wholesale Pty Ltd*. [67]

81. It has been contended that this treatment is inconsistent with the present Ruling, and that it is inappropriate to treat similar models in different industries differently. However, we do not accept that there is an inconsistency. The service provider does not carry on a business of trading in seismic data licences. That is, it does not buy, resell, distribute or sub-license its licences. It creates the data, which it owns, and from which copies of data segments are made and licensed to end customers. It does not release the master copy, or any copyright over the data. The continuity in the exclusive ownership of the data distinguishes the service provider's business from that in *Sutton Motors*, where goods changed possession.

82. It has also been put to us that Taxation Ruling IT 2646 *Income tax: television program licences* is relevant, because it discusses an entity that acquired program licences for a defined period. However, this again deals with content that the licensee does not produce, which is quite different from the circumstances considered in this draft Ruling.

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[66] *Sun Newspapers & Anor v. Federal Commissioner of Taxation* (1938) 61 CLR 337 at 362, per Dixon J. As to what is meant by 'recurrent expenditure', see, for example, *Commissioner of Taxation v. Email Ltd* 99 ATC 4868 at 4875.
[67] (1985) 157 CLR 277; 85 ATC 4398; 16 ATR 567.

83. Selected paragraphs from Taxation Ruling TR 2017/1 *Income tax: deductions for mining and petroleum exploration expenditure* have been cited[68] in opposition to the position adopted in this draft Ruling. TR 2017/1 is about characterising the expenditure of mining entities, which are in the business of exploiting the minerals found by their exploration and prospecting activities.[69] That is, it addresses the customers of the service provider.[70]

84. Furthermore, TR 2017/1 is not authority for the proposition that expenditure on activities to create a data asset can never be on capital account. In forming the view in this draft Ruling that the expenditure mentioned in paragraph 1 is on capital account, we have considered a number of aspects besides the production of information and property rights, including:

- the nature of the entity
- the relevant 'asset' (the seismic data) in question
- how the data is created, owned and used
- the service provider's business model, and
- the terms and tenure of the seismic data licensing agreement.[71]

Arguments based on timing of revenue and accounting

85. It has been argued that the expenditure on generating seismic data does not provide an enduring benefit for the service provider, for the following reasons:

- the multi-client model is focussed on near-term revenue and pre-funding
- most revenue is generated during the work-in-progress period, and
- typically, little if any revenue is expected to be generated more than five years after the completion of a seismic survey.

This is recognised for accounting purposes by amortising the expenditure over four years and by impairments to assets capitalised to a multi-client data library.

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[68] In particular, paragraphs 17, 23 and 217 to 221.
[69] See the references to 'miner' and 'mining company', to whom 'decision (or commitment) to mine', 'whether to mine' and 'how to mine' references in the context used in that Ruling are applicable.
[70] See further paragraphs 41 to 48 of this draft Ruling.
[71] Our conclusion is not based (using the language of TR 2017/1), on the 'mere' fact that some property right emerges from the expenditure incurred or the 'mere' fact the expenditure produces information.

86. The data, it is argued, has negligible value after about four years, despite the much longer (typically 25 year) terms of the licensing contracts. It is also argued that where an exploration and prospecting company is granted a licence or exploration permit over the area of a seismic survey, the service provider will have difficulty generating further income from it.

87. We do not consider that the timing of the revenue generated by licensing the data is conclusive. There is no general principle in taxation law of matching the timing of assessability of income with the timing of deductions for expenditure incurred in producing it. The character of an item of expenditure should not be confused with the character of the receipt associated with that expenditure. The character of one does not dictate the character of the other.[72]

88. Depreciation for tax purposes is not the same as for accounting purposes. The legislature has imposed a 15 year statutory effective life on MQPI, which is still significantly less than the typical period of restriction for licensees of multi-client seismic data. Service providers are at liberty to make contracts to suit their circumstances, which may include shortening restriction periods if longer ones are of no practical economic or commercial consequence or benefit.

89. It is also often the case that a service provider will include an uplift clause in the licence agreements such that additional fees are payable, among others, if a licensee is granted a licence or exploration permit over the relevant survey area.

Conclusion

90. It remains our view that the expenditure referred to in paragraph 1 of this draft Ruling is capital expenditure. The service provider cannot therefore deduct it under section 8-1. However, the service provider may incorporate the expenditure into the cost of each relevant data component and deduct that cost under section 40-25 over the 15 year effective life of the component, unless a balancing adjustment event occurs earlier.

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[72] As demonstrated in *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; [1990] HCA 25; 90 ATC 4413.

Appendix 4 – Your comments

91. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date or join the conversation on this draft Ruling on the Public Advice and Guidance Community on Let's Talk..

92. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**16 February 2018**
Contact officer:	**Kenneth Wee**
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Address:	**Australian Taxation Office** **GPO Box 9977** **Perth WA 6848**

Appendix 5 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2646; TD 2000/33; TR 93/12; TR 97/23; TR 2006/10; TR 2017/1

Legislative references:

- ITAA 1936
- ITAA 1936 51(1)
- ITAA 1997
- ITAA 1997 8-1
- ITAA 1997 8-1(2)(a)
- ITAA 1997 25-25
- ITAA 1997 25-90
- ITAA 1997 25-110
- ITAA 1997 26-10(1)(a)
- ITAA 1997 26-10(1)(b)
- ITAA 1997 Div 40 ITAA 1997 40-25
- ITAA 1997 40-25(1)
- ITAA 1997 40-30(1)
- ITAA 1997 40-30(2)
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- ITAA 1997 40-30(4)
- ITAA 1997 40-40
- ITAA 1997 40-60
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- ITAA 1997 40-95
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- ITAA 1997 40-730(8)
- ITAA 1997 Subdiv 40-C
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- ITAA 1997 70-10(2)
- ITAA 1997 70-25
- ITAA 1997 108-5(1)
- ITAA 1997 230-15(2)
- ITAA 1997 230-15(3)
- ITAA 1997 Div 230
- ITAA 1997 Subdiv 290-B
- ITAA 1997 775-30
- Mineral Resources Act 1989 (Qld)
- Mining Act 1978 (WA)
- Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth)
- Tax and Superannuation Laws Amendment (2014 Measures No. 3) Act 2014

Cases relied on:

- AusNet Transmission Group Pty Ltd v. Federal Commissioner of Taxation 2015 ATC 20-521; [2015] HCA 25; (2015) 89 ALJR 707; [2015] ALMD 3954; [2015] ALMD 4184; (2015) 322 ALR 385; (2015) 255 CLR 439; (2015) 99 ATR 816
- Brent v. Federal Commissioner of Taxation (1971) 125 CLR 418; (1971) 45 ALJR 557; (1971) 2 ATR 563; 71 ATC 4195; [1971] HCA 48
- BP Australia Ltd v. Federal Commissioner of Taxation - (1965) 112 CLR 386; (1965) 39 ALJR 190; [1966] ALR 274;

(1965) 14 ATD 1; [1966] AC 224; [1965] 3 WLR 608; [1965] 3 All ER 209; [1965] TR 317; 44 ATC 312
- British Insulated and Helsby Cables Ltd v. Atherton [1926] AC 205
- Colonial Mutual Life Assurance Society Ltd v. Federal Commissioner of Taxation (1953) 89 CLR 428; (1953) 27 ALJ 475; (1953) 10 ATD 274; (1953) 93 ALR 193; [1953] HCA 68
- Commissioner of Taxation v. Ampol Exploration Ltd (1986) 13 FCR 545; (1986) 69 ALR 289; (1986) 18 ATR 102; 86 ATC 4859
- Commissioner of Taxation v. Email Ltd [1999] FCA 1177; (1999) 42 ATR 698; 99 ATC 4868
- Commissioner of Taxation v. Star City Pty Ltd - [2009] FCAFC 19; 2009 ATC 20-093; (2009) 175 FCR 39; (2009) 72 ATR 431; [2010] ALMD 7489; [2010] ALMD 7492
- Federal Commissioner of Taxation v. Suttons Motors (Chullora) Wholesale Pty Ltd (1985) 157 CLR 277; (1985) 59 ALJR 615; (1985) 59 ALR 688; (1985) 16 ATR 567; 85 ATC 4398; [1985] HCA 44
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- Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation (1991) 29 FCR 376; (1991) 101 ALR 329; (1991) 22 ATR 26; 91 ATC 4438
- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; (1990) 64 ALJR 392; (1990) 93 ALR 193; (1990) 21 ATR 1; 90 ATC 4413; [1990] HCA 25
- Hallstroms Pty Ltd v. Federal Commissioner of Taxation (1946) 72 CLR 634; (1946) 20 ALJ 277; (1946) 8 ATD 190; [1946] ALR 434; [1946] HCA 34
- John v. Federal Commissioner of Taxation (1989) 166 CLR 417; (1989) 63 ALJR 166; (1989) 83 ALR 606; (1989) 20 ATR 1; 89 ATC 4101; [1989] ACL 36017; [1989] HCA 5
- John Fairfax and Sons Pty Ltd v. Federal Commissioner of Taxation - (1959) 101 CLR 30; (1959) 32 ALJR 370; (1959) 11 ATD 510; [1959] ALR 267; [1959] HCA 4
- Ronpibon Tin NL v. Federal Commissioner of Taxation - (1949) 78 CLR 47; (1949) 23 ALJ 139; (1949) 8 ATD 431; [1949] ALR (CN) 1055; [1949] ALR 785; [1949] HCA 15
- Steele v. Deputy Commissioner of Taxation - (1999) 197 CLR 459; (1999) 73 ALJR 437; (1999) 41 ATR 139; (1999) 161 ALR 201; 99 ATC 4242; [1999] HCA 7
- Sun Newspapers Ltd and Associated Newspapers Ltd v. Federal Commissioner of Taxation - (1938) 5 ATD 87; [1939] ALR 10; (1938) 61 CLR 337; (1938) 12 ALJR 411; (1938) 1 AITR 403
- Western Gold Mines (NL) v. Commissioner of Taxation (WA) (1938) [1938] HCA 5; (1938) 59 CLR 729; (1938) 4 ATD 453; [1938] ALR 203; (1938) 11 ALJ 526

Cases distinguished:

- BP Australia Ltd v. Federal Commissioner of Taxation - (1965) 112 CLR 386; (1965) 39 ALJR 190; [1966] ALR 274; (1965) 14 ATD 1; [1966] AC 224; [1965] 3 WLR 608; [1965] 3 All ER 209; [1965] TR 317; 44 ATC 312
- Commissioner of Taxation v. Ampol Exploration Ltd (1986) 13 FCR 545; (1986) 69 ALR 289; (1986) 18 ATR 102; 86 ATC 4859

- Goodman Fielder Wattie Ltd v. Federal Commissioner of Taxation (1991) 29 FCR 376; (1991) 101 ALR 329; (1991) 22 ATR 26; 91 ATC 4438
- National Australia Bank Ltd v. Commissioner of Taxation - (11 December 1997) - (1997) 80 FCR 352; (1997) 37 ATR 378; (1997) 151 ALR 225; 97 ATC 5153

Other references:

- Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014
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ATO references

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