MT 2012/2 - Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements

This ruling is being reviewed as a result of a recent court/tribunal decision. Refer to Decision Impact Statement: Commissioner of Taxation v Shell Energy Holdings Australia Limited (P4 of 2022 (special leave application) WAD146 of 2021 WAD391 of 2019).

There is a Compendium for this document: **MT 2012/2EC** .

This document has changed over time. This is a consolidated version of the ruling which was published on *13 December 2017*

Miscellaneous Taxation Ruling

Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements

Contents Para

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

*[**Note**: This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

What this Ruling is about

1. This Ruling sets out the Commissioner's views on the application of the income tax and goods and services tax (GST) provisions upon entry into a deferred transfer farm-out arrangement as described in paragraph 13 of this Ruling.[1]

2. In particular, for income tax purposes, the Ruling explains the application of the following provisions to deferred transfer farm-out arrangements:

- the capital gains tax (CGT) provisions;[2]
- the uniform capital allowance (UCA) provisions;[3] and
- sections 6-5, 8-1, 15-2 and 15-40 of the ITAA 1997.

[1] For the income tax law, the *Income Tax Assessment Act 1997* is referred to as the ITAA 1997; the *Income Tax Assessment Act 1936* is referred to as the ITAA 1936. For the GST law, the *A New Tax System (Goods and Services Tax) Act 1999* is referred to as the GST Act.
[2] See Part 3-1 of the ITAA 1997.
[3] See Division 40 of the ITAA 1997.

3. This Ruling does not discuss the application of the income tax and GST provisions to:

- the actual joint venture arrangement that is in existence or that may be formed as a result of, and at the time of, the transfer of an interest in the mining tenement to the farmee under a deferred transfer farm-out arrangement; or
- an immediate transfer farm-out arrangement. An immediate transfer farm-out arrangement is discussed in Miscellaneous Taxation Ruling MT 2012/1.[4]

Background

4. Farm-out arrangements are common in the mining and petroleum industries. Broadly speaking, they are arrangements entered into for the purpose of facilitating exploration for the discovery of minerals and petroleum resources.

5. A typical arrangement provides for the owner of an interest in a mining tenement[5] (the 'farmor') to transfer a percentage of that interest to another party (the 'farmee') if the farmee meets specified exploration commitments or contributes monetary payments.

6. Often the commercial driver for such an arrangement from the farmor's perspective is funding. That is, 'the farmor giving up future economic benefits, in the form of reserves, in exchange for a reduction in future funding obligations'.[6] For the farmee, it provides an opportunity to acquire an interest in a mining tenement.[7]

7. Broadly, farm-out arrangements may be divided into two types referred to as 'immediate transfer' and 'deferred transfer' farm-out arrangements.[8]

Deferred transfer farm-out arrangement

8. Under a deferred transfer farm-out arrangement, the terms of the arrangement specify that the transfer of an interest in the mining tenement from the farmor to the farmee occurs only after the farmee has met all of the exploration commitments and any payment requirements to earn that interest (collectively referred to as the earn-in requirements) within a specified period of time (the earn-in period).

---

[4] MT 2012/1: application of the income tax and GST laws to immediate transfer farm-out arrangements.
[5] The term 'mining tenement' is used throughout this Ruling as a reference to a *mining, quarrying or prospecting right* as defined in subsection 995-1(1) of the ITAA 1997.
[6] Mining and Metals Refining IFRS, May 2009, available at www.ey.com.au.
[7] Birch, Charles, 'Choosing the Right Joint Venture Structure for a Farmin or Farmout' [2002] JIATax 3; (2002) 5 (1) Journal of Australian Taxation 60.
[8] See footnote 7.

9. Certain exploration commitments or payments may be mandatory upon entering into the agreement. However, most (if not all) of the exploration commitments and payments are at the discretion of the farmee. Monetary payments (if any) may be made upon entering into the agreement, while the agreement is on foot or at a later stage when the right to acquire an interest in the mining tenement is exercised or upon transfer of the interest to the farmee. The farmee may also be subject to other conditions during the earn-in period and while the agreement is on foot, such as enabling the farmor to comply with the requirements of the relevant Act applicable to the grant of the mining tenement and providing updates as to exploration expenditure and results. Thus, the farmee's expenditure typically results, at least to some extent, in the farmor meeting its commitments under the relevant Act, for example, the *Mineral Resources Act 1989* (QLD).

10. The farmee is able to terminate the agreement at any time (save perhaps for an initial period such as the first 12 months) provided the mining tenement is in good order at the time of giving notice to terminate to the farmor. If the farmee does not satisfy the earn-in requirements during the earn-in period, the farmee does not earn the specified interest in the mining tenement.

11. To facilitate the farmee satisfying the earn-in requirements, the farmor grants to the farmee a right to exclusive use and access of the mining tenement. The farmor also typically provides access to any mining information it has. If the farmee does earn the specified interest in the mining tenement, the farmee becomes a holder of that interest in the mining tenement. The farmor is left with a reduced percentage interest in the mining tenement.

12. The agreement is usually subject to other conditions imposed on both the farmor and farmee. For example, the farmee will typically covenant to comply with relevant laws and the farmor will typically covenant that it has sufficient interest in the mining tenement to meet its obligation, should it arise, to transfer the earned interest to the farmee. The agreement will also typically deal with seeking the permission or agreement of the relevant authority for the transfer of the interest.

Class of arrangement/scheme

13. This Ruling applies to a deferred transfer farm-out arrangement that has the following characteristics:

The farmor	The farmee
• Provides the farmee with a right (akin to an option) to acquire an interest in a mining tenement by satisfying the earn-in requirements over the earn-in period. • Provides the farmee with exclusive use and access rights (akin to a licence). • Transfers a percentage interest in the mining tenement to the farmee at the end of the earn-in period if the farmee exercises the right to acquire the interest in the mining tenement (and all necessary approvals[9] are granted). This leaves the farmor with a reduced percentage interest in that mining tenement.[10] • May also share mining information with the farmee.	• Undertakes exploration commitments,[11] which may be referrable to a period of time; an amount(s); a schedule of works; or a combination thereof. Under the terms of the agreement, the exploration commitments may to some extent be mandatory but most, if not all, of the exploration commitments will be at the discretion of the farmee. • May also make cash payments to the farmor. These payments may, or may not, be referrable to the exploration costs the farmor has incurred prior to entering into the deferred transfer farm-out arrangement. Payment(s) may also be made at the time of exercising the right to acquire, or upon transfer of, the interest in the mining tenement. • May also make cash payments to third parties to meet expenses incurred by the farmor thereby relieving the farmor from meeting those expenses.

Other rights under the arrangement

14. This Ruling does not deal with the taxation consequences of clauses dealing with rights in relation to the interest in the mining tenement that are more than merely incidental to the transfer of that interest.

[9] For example, Ministerial or Foreign Investment Review Board approval.
[10] The parties would typically enter into a joint venture arrangement, or the farmee would become a joint venturer if such an arrangement already exists.
[11] That is, the farmee carries out the exploration or contracts other entities to carry out the exploration on its behalf. It is the farmee that incurs the exploration expenditure.

Applying this Ruling

15. This Ruling sets out the Commissioner's view on the character of deferred transfer farm-out arrangements and the income tax and GST consequences for a taxpayer flowing from that characterisation. If the characterisation of all aspects of a particular arrangement for that taxpayer is not consistent with the characterisation set out in this Ruling, this Ruling does not apply to the arrangement for that taxpayer.

16. For example, if instead of carrying out exploration the farmee is required to make cash payments to a joint venture on behalf of the farmor, to meet cash calls that the farmor would otherwise be obliged to meet in respect of the farmor's interest in the mining tenement, this Ruling would not apply.

17. As it is not possible to comprehensively deal with the multitude of ways in which a deferred transfer farm-out arrangement may be structured, you may need to seek a private ruling if your arrangement is not comparable to that discussed in this Ruling.

Ruling

Characterisation of the arrangement

18. Paragraphs 19 to 34 of this Ruling set out how a deferred transfer farm-out arrangement covered by this Ruling is characterised.

The right to acquire an interest in a mining tenement

19. Upon entering into a deferred transfer farm-out agreement, the farmor grants to the farmee a right (akin to an option) to acquire an interest in a mining tenement. The farmee's exercise of that right is subject to the farmee satisfying the earn-in requirements within the earn-in period.

20. The grant of the right (option) to acquire an interest in the mining tenement is often in return for a nominal cash payment, although this may vary and will necessarily depend on the terms of the agreement.

21. The grant of the right to acquire an interest in the mining tenement is treated in this Ruling as being on capital account.[12]

The exclusive use and access rights

22. The farmor grants exclusive use and access rights (akin to a licence) to the farmee to facilitate the farmee carrying out the exploration commitments.

[12] This is discussed further at paragraphs 39 to 42 of this Ruling.

23. The consideration for the grant of these rights will depend upon the terms of the agreement. However, the approach under this Ruling is to treat cash payments[13] that are required to be made by the farmee either to, or on behalf of, the farmor while the agreement is on foot, as being in return for the grant of these rights. Thus, consideration for the grant of these rights includes cash payments to the farmor, or to third parties for the payment of fees, rates and other charges that are incurred by the farmor, but are met by the farmee while the agreement is on foot.

24. This approach effectively recognises a correlation between the ongoing use and enjoyment of the exclusive use and access rights and the ongoing requirement to make such payments either to the farmor, or on the farmor's behalf, until the farmee either:

- opts to discontinue carrying out the exploration commitments (in which case the earn-in requirements are not satisfied and there is no transfer of the interest in the mining tenement);
- satisfies the earn-in requirements and exercises the right to acquire the interest in the mining tenement; or
- satisfies the earn-in requirements but does not exercise the right to acquire the interest in the mining tenement.

25. The grant of the exclusive use and access rights is treated in this Ruling as being on revenue account.[14] The payments received from the farmee in return for the grant of these rights are the revenue from the exploitation of an asset of the farmor, being the mining tenement it holds.

Allocation and apportionment

26. The allocation and apportionment of payments between the rights to acquire an interest in the mining tenement and the exclusive use and access rights necessarily depends on the terms of the arrangement and any other relevant facts and circumstances.

27. The apportionment of such payments as between these rights will have particular implications for income tax and GST[15] purposes.

---

[13] This would not include any payments that are for the interest in the mining tenement and made upon exercise of the right to acquire the interest or upon transfer of the interest.

[14] This is discussed further at paragraphs 43 to 45 of this Ruling.

[15] For GST purposes, apportionment between the two supplies is relevant if, for example, the farmor or the farmee accounts for GST on a non-cash basis and the consideration for the supply of the right to acquire an interest is known and the basic attribution rules apply, but the consideration for the supply of the rights to exclusive use and access is unknown and a legislative instrument applies for attribution purposes. Practically, however, it may not be of significance.

Transfer of the interest in the mining tenement

28. If the farmee satisfies the earn-in requirements and exercises the right to acquire an interest in the mining tenement (and all necessary approvals are granted), there is a transfer of the legal title in the agreed percentage interest in the mining tenement by the farmor to the farmee. This leaves the farmor with a reduced percentage interest in that mining tenement.

29. In return for the transfer of the interest in the mining tenement, the farmor:

(i) receives, or has received, a non-cash benefit in the nature of a service arising from the farmee undertaking exploration commitments. The farmee may either carry out the exploration itself or contract a third party to carry out the exploration on its behalf. In this Ruling, the provision of this non-cash benefit is referred to as the provision of an 'exploration benefit'; and

(ii) upon the exercise of the right to acquire the interest or upon transfer of the interest, may also receive, or constructively receive,[16] cash payments from the farmee.

30. The farmee's provision of the exploration benefit to the farmor is for reward to the extent that the exploration benefit secures for the farmee the transfer of the interest in the mining tenement. The Ruling proceeds on the basis that the provision of the exploration benefit by the farmee is on revenue account.

No transfer of the interest in the mining tenement

31. If the farmee does not satisfy the earn-in requirements, or does not exercise the right to acquire an interest in the mining tenement, there is no transfer of the interest by the farmor to the farmee. The farmor has, however, still received an exploration benefit from the farmee to the extent that the farmee has undertaken any of the exploration commitments. This exploration benefit is a non-cash business benefit to the farmor.[17]

[16] For example, if the farmor directed the farmee to make the payment to a third party on its behalf.
[17] This is discussed further at paragraphs 74 to 76 of this Ruling.

Mining information

32. Mining information[18] shared by the farmor with the farmee on entering into the agreement is treated as a non-cash benefit separate to the rights granted by the farmor, if the parties have identified consideration provided by the farmee as being for that information. The sharing of mining information in these circumstances is the provision of a service by the farmor to the farmee, which will give rise to tax consequences.

33. However, if the sharing of mining information is merely to facilitate the farmee's exploration of the mining tenement, and consequently separate consideration has not been identified for it, the farmor's sharing of that information with the farmee is merely incidental to the rights granted by the farmor on entering into the agreement rather than the provision of a non-cash benefit. In this case, the farmor's sharing of mining information with the farmee will not give rise to additional income tax or GST consequences.

34. Additionally, the farmee sharing mining information with the farmor does not give rise to additional income tax or GST consequences if that information arises from the farmee's exploration and is merely a part of the exploration benefit.[19]

Market valuation

35. If the parties are dealing with each other at arm's length, it is accepted that the market value of the exploration benefit provided by the farmee and any cash payments made to, or on behalf of, the farmor by the farmee is equal to the market value of the interest in the mining tenement and any other benefits that are provided by the farmor.[20]

36. In the context of these arrangements, the relevant time for determining the market value of the interest in the mining tenement that is transferred by the farmor, and any other non-cash benefits, is at the time of entering into the farm-out agreement.

37. The market valuation must take into account all the facts and surrounding circumstances.[21] The value of an exploration benefit provided by the farmee to the farmor does not necessarily equate with the amount to be spent by the farmee on exploration.

---

[18] The term 'mining information' is used throughout this Ruling as a reference to *mining, quarrying or prospecting information* as defined in subsection 995-1(1) of the ITAA 1997.
[19] This is discussed further at paragraphs 80 to 82 of this Ruling.
[20] This is consistent with Goods and Services Tax Ruling GSTR 2001/6: non-monetary consideration (see paragraphs 19 and 138 of that Ruling).
[21] This is discussed further at paragraphs 144 to 150 of this Ruling.

Application of the income tax provisions

38. Based on the characterisation of a deferred transfer farm-out arrangement as set out in paragraphs 19 to 34 of this Ruling, the income tax consequences for the following transactions are explained:

- (i) the grant of the right to acquire an interest in the mining tenement (paragraphs 39 to 42 of this Ruling);
- (ii) the grant of exclusive use and access rights (paragraphs 43 to 47 of this Ruling);
- (iii) the provision of the exploration benefit by the farmee and the transfer of an interest in the mining tenement by the farmor (paragraphs 48 to 73 of this Ruling);
- (iv) the provision of the exploration benefit but no transfer of any interest in the mining tenement (paragraphs 74 to 79 of this Ruling); and
- (v) the sharing of mining information (paragraphs 80 to 82 of this Ruling).

(i) Grant of the right to acquire an interest in the mining tenement

Consequences for the farmor

39. The farmor granting a right (akin to an option) to the farmee to acquire an interest in a mining tenement results in CGT event D2[22] happening to the farmor.

40. The capital proceeds are the cash payments the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the right.[23] The farmor makes a capital gain if the capital proceeds from the grant are more than the expenditure incurred to grant it.

Consequences for the farmee

41. The farmee acquires a CGT asset, being the right to acquire an interest in the mining tenement. The cash payments made by the farmee for the right to acquire the interest in the mining tenement are included in the cost base of the right.

[22] Section 104-40 of the ITAA 1997.
[23] Section 116-20 of the ITAA 1997.

42. Upon the ending of the right to acquire the interest, CGT event C2[24] happens to the farmee. If the cash payments made by the farmee for the right are not deductible to the farmee and there are no capital proceeds, the farmee will make a capital loss equal to the cost base of that right. The capital loss is made in the income year in which the ending of the right occurs.

(ii) Grant of exclusive use and access rights

Consequences for the farmor

43. On the basis that the grant by the farmor to the farmee of exclusive use and access rights is on revenue account,[25] the cash payments[26] to, or on behalf of, the farmor in return for the grant of those rights are assessable income of the farmor under section 6-5 of the ITAA 1997. These cash payments are assessable income in the income year in which the payments are derived.

44. The grant of the exclusive use and access rights also results in CGT event D1 happening to the farmor when the farmor grants the right.[27] The capital proceeds are the cash payments the farmor has received or is entitled to receive and the market value of any property that the farmor has received or is entitled to receive for the grant of the exclusive use and access rights. However, as the reward for the grant of the rights is on revenue account for the farmor, section 118-20 of the ITAA 1997 reduces any capital gain made under CGT event D1 that is otherwise included in assessable income.

45. The fees, rates and charges or other expenses incurred by the farmor for the maintenance of the mining tenement are deductible under section 8-1 of the ITAA 1997 if the requirements of that section are satisfied. The deduction is allowed in the income year in which the expenses are incurred.

Consequences for the farmee

46. The farmee can deduct expenditure incurred on acquiring the exclusive use and access rights under section 8-1 of the ITAA 1997 if the requirements of section 8-1 of the ITAA 1997 are satisfied. The deduction is allowed in the income year in which the expenditure is incurred.

47. Upon the ending of the exclusive use and access rights, CGT event C2 happens to the farmee. If the cash payments made by the farmee for the rights are not deductible to the farmee and there are no capital proceeds, the farmee will make a capital loss equal to the cost base of the rights. The capital loss is made in the income year in which the ending of the rights occurs.

---

[24] Section 104-25 of the ITAA 1997.
[25] Examples 3 and 4 at paragraphs 115 and 119 of this Ruling respectively proceed on this basis.
[26] See paragraph 23 of this Ruling.
[27] Section 104-35 of the ITAA 1997.

(iii) The provision of the exploration benefit by the farmee and the transfer of an interest in the mining tenement by the farmor

Consequences for the farmor

UCA – balancing adjustment event

48. A balancing adjustment event occurs for the interest in the mining tenement transferred by the farmor when the farmee begins to hold the interest in the mining tenement under section 40-40 of the ITAA 1997.[28]

49. A balancing adjustment amount is included in the farmor's assessable income if the termination value of the interest in the mining tenement that is transferred by the farmor is more than its adjustable value just before the event occurred.

50. The adjustable value of the interest in the mining tenement transferred by the farmor is a reasonable proportion of the adjustable value of the interest in the mining tenement before it was split into two assets[29] along with a reasonable proportion of any other capital costs involved in splitting the asset.[30]

51. The termination value of the interest in the mining tenement transferred by the farmor is the sum of the following:

- the market value of the exploration benefit received (a non-cash benefit received);[31] and
- any cash payments received, or constructively received, by the farmor from the farmee upon the farmee's exercise of the right to acquire the interest in the mining tenement or upon transfer of that interest to the farmee (an amount received);[32] and
- the amount of the capital proceeds received under CGT event D2 for the grant of the right to acquire the interest in the mining tenement.[33] (See paragraphs 57 and 58 of this Ruling which explain the CGT and UCA interaction).

[28] When the farmee begins to hold the interest in the mining tenement under section 40-40 of the ITAA 1997 is discussed at paragraphs 59 to 63 of this Ruling.
[29] The two assets being the interest the farmor retains and the interest the farmor transfers to the farmee.
[30] Section 40-205 of the ITAA 1997.
[31] See item 4 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[32] See item 1 of the table in paragraph 40-305(1)(b) of the ITAA 1997.
[33] See item 1 of the table in paragraph 40-305(1)(b) of the ITAA 1997.

UCA – exploration or prospecting expenditure deductions

52. The interest in the mining tenement that the farmor transfers to the farmee is in return for exploration or prospecting to the extent that the transfer of the interest secures the exploration benefit for the farmor. The farmor is, therefore, entitled to a deduction to that extent under subsection 40-730(1) of the ITAA 1997, subject to subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying to exclude the expenditure.[34]

53. If subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply:

- the deduction is allowed in the income year in which the expenditure is incurred. That is, the income year in which the farmee exercises the right to acquire the interest in the mining tenement on the basis that the farmor has an obligation to transfer the interest in the mining tenement at that time; and
- the amount of the deduction is equal to the market value of the interest in the mining tenement at the time of entry into the farm-out agreement, to the extent that the interest in the mining tenement secures the exploration benefit for the farmor.[35]

54. Subsection 40-730(2) of the ITAA 1997 applies to exclude expenditure if the expenditure is on the following activities:

- development drilling for petroleum; or
- operations in the course of working a mining property, quarrying property or petroleum field.

55. Whether it is expenditure on an activity listed under subsection 40-730(2) of the ITAA 1997 will necessarily depend on the particular facts and circumstances.

56. Subsection 40-730(3) of the ITAA 1997 applies to exclude expenditure if the expenditure forms part of the cost of a depreciating asset.

---

[34] See paragraphs 161 to 169 of this Ruling.
[35] The Ruling assumes an accruals basis.

CGT – CGT events D2 and A1 disregarded

57. CGT event D2[36] happened to the farmor upon the farmor granting the right to the farmee to acquire an interest in the mining tenement (see paragraph 39 of this Ruling). However, if there is a transfer of the interest in the mining tenement by the farmor to the farmee (CGT event A1), the capital gain or capital loss made by the farmor under CGT event D2 is disregarded.[37] The capital proceeds for the grant of that right that would have been included in working out any capital gain or capital loss made under CGT event D2 are included in the capital proceeds from CGT event A1.[38]

58. CGT event A1 happens[39] to the farmor for the interest in the mining tenement that is transferred by the farmor to the farmee.[40] However, subsection 118-24(1) of the ITAA 1997 applies to disregard any capital gain or capital loss made on the transfer of the interest in the mining tenement if the decline in value of the interest in the mining tenement is (or would be, if it was used) worked out under the UCA provisions. This is subject to the exclusions set out in subsection 118-24(2) of the ITAA 1997, which are not considered relevant to these circumstances. The capital proceeds from CGT event A1 (including the capital proceeds from CGT event D2) are included in the termination value of the interest in the mining tenement as these are amounts that the farmor is taken to have received under a balancing adjustment event.

Consequences for the farmee

UCA – when the farmee begins to hold the interest in the mining tenement

59. The farmee begins to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the farmee exercises the right to acquire the interest if at that time the farmee:

- exercises, or has a right to exercise immediately, the rights in relation to the interest in the mining tenement; and
- has a right to become the legal owner of the interest in the mining tenement and there is a reasonable expectation that legal ownership will transfer to the farmee.

---

[36] Section 104-40 of the ITAA 1997.
[37] Subsection 104-40(5) of the ITAA 1997.
[38] Item 1 of the table in subsection 134-1(1) of the ITAA 1997 refers the grantor of the right (the farmor) to section 116-65 of the ITAA 1997. Under section 116-65 of the ITAA 1997, the capital proceeds received by the farmor for disposal of the interest in the mining tenement under CGT event A1 also includes any payments or property received by the farmor under CGT event D2 for the granting of the right.
[39] See subsection 104-10(3) of the ITAA 1997 as to when the event happens.
[40] Section 104-10 of the ITAA 1997.

60. Whether this is the case will depend on the particular facts and circumstances.

61. If the farmee does not have a right to become the legal owner of the interest in the mining tenement until requisite approvals under any applicable legislation have been obtained, then the farmee will not begin to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the right is exercised.

62. However, if the completion of the agreement is conditional on obtaining Ministerial approval to change title to the interest in the mining tenement, these circumstances of themselves do not prevent the farmee from beginning to hold the interest in the mining tenement under item 5 of the table in section 40-40 of the ITAA 1997 at the time when the right is exercised.

63. When the farmee becomes the legal owner of the interest in the mining tenement, the farmee begins to hold the interest in the mining tenement under item 10 of the table in section 40-40 of the ITAA 1997.

UCA – the cost of the interest in the mining tenement

64. The first element of cost of the interest in the mining tenement is the same amount as the farmor's termination value of that interest.[41]

UCA – the amount of the decline in value of the interest in the mining tenement

65. The farmee is entitled to a decline in value deduction for the first element of cost of the interest in the mining tenement to the extent it is used for a taxable purpose.[42]

66. If the farmee's first use of the interest in the mining tenement after the farmee begins to hold it is for exploration or prospecting, and all of the requirements of subsection 40-80(1) of the ITAA 1997 are satisfied, the decline in value deduction for the farmee is the cost of the interest.[43] That is, the farmee is entitled to an immediate deduction for the cost of the interest. The deduction is allowed in the income year in which the start time for the interest in the mining tenement occurs.[44] That is, the deduction is allowed in the income year in which the interest in the mining tenement is first used for exploration or prospecting.

[41] See items 1 and 4 of the table in paragraph 40-185(1)(b) of the ITAA 1997.
[42] See subsection 40-25(1) of the ITAA 1997.
[43] The effect of subsection 40-80(1) of the ITAA 1997 as it applies to subsection 40-25(1) of the ITAA 1997.
[44] Section 40-60 of the ITAA 1997.

67. The question of whether the farmee's first use of the interest in the mining tenement is for exploration or prospecting, after the farmee begins to hold it, necessarily depends on the particular facts and circumstances.

68. If the interest in the mining tenement is not first used for exploration or prospecting, then the farmee is entitled to an annual decline in value deduction for the interest in the mining tenement under subsection 40-25(1) of the ITAA 1997.

UCA – exploration or prospecting expenditure deductions

69. The farmee is entitled to a deduction for expenditure incurred on exploration or prospecting under subsection 40-730(1) of the ITAA 1997.[45] The deduction is allowed in the income year in which the expenditure is incurred.

Ordinary income and deduction provisions – farmee's reward for providing the exploration benefit

70. To the extent that the interest in the mining tenement received by the farmee is reward for the provision of the exploration benefit (a non-cash benefit in the nature of a service) by the farmee to the farmor, the market value of the interest in the mining tenement is assessable income to the farmee under section 6-5 or 15-2 of the ITAA 1997.

71. It is assessable income in the income year in which the farmee exercises the right to acquire the interest in the mining tenement.

Ordinary income and deduction provisions – farmee's exploration related expenditure

72. Expenditure by the farmee that relates to exploration by the farmee but which is not incurred on exploration or prospecting for the purposes of subsection 40-730(1) of the ITAA 1997 is deductible under section 8-1 of the ITAA 1997 if it is of a revenue character and the other requirements of section 8-1 of the ITAA 1997 are satisfied. An example is salary or wages of employees involved in general administration work for the farmee. The deduction is allowed in the income year in which the expenditure is incurred.

---

[45] This is if all of the other requirements of the provision have been satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply. The discussion in paragraphs 53 to 56 as to whether subsections 40-730(2) and 40-730(3) of the ITAA 1997 apply to the farmor also applies to the farmee.

CGT consequences for the farmee

73. The farmee acquires a CGT asset, being the interest in the mining tenement. Aside from this, there are no CGT consequences for the farmee upon the actual transfer of the interest in the mining tenement. Further, as discussed in paragraphs 42 and 47 of this Ruling, CGT event C2 happens to the farmee upon the ending of the right to acquire the interest and upon the ending of the exclusive use and access rights respectively.

(iv) The provision of the exploration benefit but no transfer of any interest in the mining tenement

Consequences for the farmor

74. The exploration benefit that the farmee's exploration gives rise to is a non-cash business benefit for the farmor.[46] It is a non-cash business benefit that is not convertible to cash and, therefore, it is a benefit to which subsection 21A(1) of the ITAA 1936 applies to treat the benefit as if it were convertible to cash with its value being determined under subsection 21A(2) of the ITAA 1936.

75. However, subsection 21A(3) of the ITAA 1936 can also apply in respect of each income year in which the exploration benefit is received by the farmor. The effect of subsection 21A(3) of the ITAA 1936 is to reduce the value of the benefit to the extent that the farmor would have been entitled to a deduction had the farmor incurred and paid unreimbursed expenditure in respect of the provision of the benefit.

76. Thus, on the basis that the farmor would have been entitled to a deduction for such expenditure under subsection 40-730(1) of the ITAA 1997, no amount is returned as assessable income by the farmor in respect of that non-cash business benefit in each relevant income year that such an exploration benefit is received. If there is no entitlement to this deduction in the farmor's particular circumstances, subsection 21A(3) of the ITAA 1936 does not reduce the value of the benefit.

Consequences for the farmee

77. For the farmee, there is no reward for the farmee's provision of the exploration benefit as there is no transfer of the interest in the mining tenement. Therefore, there is no amount assessable to the farmee in return for its provision of the exploration benefit.

78. The farmee may nonetheless be entitled to deductions for expenditure under subsection 40-730(1) or section 8-1 of the ITAA 1997.

---

[46] Non-cash business benefit is defined in subsection 21A(5) of the ITAA 1936.

79. As discussed in paragraphs 42 and 47 of this Ruling, CGT event C2 happens to the farmee upon the ending of the right to acquire the interest and upon the ending of the exclusive use and access rights respectively.

(v) Sharing mining information

Consequences for the farmor

80. If the parties have identified consideration provided by the farmee as being for mining information shared[47] by the farmor with the farmee on entering into the agreement, the consideration is assessable income of the farmor under section 6-5 or 15-40 of the ITAA 1997.

81. It is assessable income of the farmor in the income year in which it is derived (section 6-5 of the ITAA 1997) or received (section 15-40 of the ITAA 1997).[48]

Consequences for the farmee

82. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee, then the farmee may be entitled to a decline in value deduction under subsection 40-25(1)[49] of the ITAA 1997 or a deduction under subsection 40-730(1) of the ITAA 1997 for the expenditure incurred on the mining information if the requirements of the provision are satisfied.

Application of the GST provisions

Grant of the right to acquire an interest in the mining tenement and the exclusive use and access rights

83. The grant of the right to acquire an interest in the mining tenement and the grant of exclusive use and access rights are taxable supplies made by the farmor if the requirements of section 9-5 of the GST Act are met. The consideration for these supplies is typically monetary as discussed at paragraphs 20 and 23 of this Ruling.

84. The farmee is entitled to input tax credits if these acquisitions are creditable acquisitions for a creditable purpose.[50]

85. The GST payable and input tax credits for the farmor and the farmee respectively, are attributable under the basic attribution rules in Division 29 of the GST Act.[51]

---

[47] That is, the farmor continues to hold that mining information.
[48] This is discussed further at paragraph 170 to 172 of this Ruling.
[49] The decline in value deduction for the farmee is the cost of the mining information if all of the requirements of subsection 40-80(1) of the ITAA 1997 have been satisfied.
[50] Section 11-5 of the GST Act.

86. If total consideration for a supply is not known and the farmor, or the farmee, accounts for GST on a basis other than cash (a 'non-cash basis') the attribution rules under *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000* apply instead of the basic attribution rules.[52] For example, it may be relevant to the supply of the exclusive use and access rights if the consideration (or part of it) includes the farmee making cash payments to third parties for fees, rates and other charges while the agreement is on foot. The particular attribution rules in the legislative instrument override the basic attribution rules and the special rules in Chapter 4 of the GST Act but only to the extent of any inconsistency and only to the extent provided for in the legislative instrument.

Supply of the interest in the mining tenement and acquisition of the exploration benefit by the farmor

GST payable

87. The supply of the interest in the mining tenement is a taxable supply if the requirements of section 9-5 of the GST Act are satisfied. The consideration for that supply is the exploration benefit along with any payments made to or on behalf of the farmor (see paragraphs 29 (i) and (ii) respectively of this Ruling).

88. Under the *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2012*[53] the attribution of GST payable on the taxable supply of the interest in the mining tenement occurs as follows:

(i) *if the farmor accounts for GST on a non-cash basis* – GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire the interest. This applies to both monetary and non-monetary consideration for the supply of the interest in the mining tenement; and

(ii) *if the farmor accounts for GST on a cash basis* – GST payable on a taxable supply of an interest in the mining tenement is attributable to the tax period in which the interest is transferred to the extent that the consideration received for that supply is the exploration benefit.

---

[51] The basic attribution rules are explained at paragraphs 13 to 45 of Goods and Services Tax Ruling GSTR 2000/29 Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25 of the GST Act.

[52] This legislative instrument (registration number: F2006B11593) is available at www.ato.gov.au. It is further explained in Goods and Services Tax Ruling GSTR 2000/29 at paragraphs 92 to 98; and 147 to 170 of that Ruling.

[53] This legislative instrument (registration number: F2012L00866) is available at www.ato.gov.au.

89. The attribution rules in the legislative instrument only override the basic attribution rules and the special rules in Chapter 4 of the GST Act to the extent of any inconsistency and only to the extent provided for in the legislative instrument.

90. A farmor that accounts for GST on a cash basis attributes the GST payable on any monetary consideration received for the taxable supply of the interest in the mining tenement to a tax period, to the extent that the monetary consideration is received in that tax period.[54]

Input tax credits

91. The farmor is also entitled to an input tax credit for the acquisition of the exploration benefit if it is a creditable acquisition.[55]

92. The basic attribution rules under Division 29 of the GST Act apply to the attribution of input tax credits.

93. The earliest tax period to which the input tax credit could be attributed for a non-cash basis farmor is the tax period in which the farmee, having satisfied the earn-in requirements, exercises the right to acquire the interest in the mining tenement and issues a tax invoice[56] to the farmor. This is the tax period to which GST payable is attributable under the legislative instrument (see paragraph 88(i) of this Ruling).

94. If a farmor accounts for GST on a cash basis the input tax credit is attributable to a tax period to the extent that consideration is provided to the farmee.[57] On this basis the input tax credit is attributable to the tax period in which the interest in the mining tenement is transferred from the farmor to the farmee, assuming the farmee has provided the farmor with a tax invoice. This is the tax period to which GST payable is attributable under the legislative instrument (see paragraph 88(ii) of this Ruling).

Example 1 – farmor's attribution of GST payable and input tax credits

95. A farmor and a farmee have entered into a deferred transfer farm-out arrangement of a kind to which this Ruling applies. Assume all amounts in this example are GST-inclusive and the supplies are taxable supplies and the acquisitions are creditable acquisitions for a fully creditable purpose.

96. The farmor grants the farmee a right to acquire an interest in the mining tenement for $1,100. The farmor is required to transfer a 25% interest in a mining tenement to the farmee if the farmee carries out exploration work to the value of $880,000 over a 3 year period and, upon exercise of the right to acquire the interest in the mining tenement, makes a cash payment to the farmor of $11,000.

---

[54] Subsection 29-5(2) of the GST Act.
[55] Section 11-5 of the GST Act.
[56] Subsection 29-10(3) of the GST Act.
[57] Subsection 29-10(2) of the GST Act.

97. The market value of the interest in the mining tenement is $110,000 at the time of entering into the agreement. Based on the principles in this Ruling the value of the exploration benefit the farmor receives is $97,900 (which includes GST of $8,900). This is worked out as $110,000[58] less $11,000[59] cash payment upon exercise of the right less $1,100,[60] which for GST purposes was consideration for the granting of the right.

98. The following transpires in relation to the interest in the mining tenement:

- tax period 1 in year 1 – the farmee commences exploration and thus commences providing the exploration benefit to the farmor;
- tax period 3 in year 3 – the exploration is completed and the provision of the exploration benefit is completed;
- tax period 4 in year 3 – the farmee exercises the right to acquire the agreed interest in the mining tenement and pays the farmor $11,000; and
- tax period 1 in year 4 – the interest in the mining tenement is transferred to the farmee from the farmor.

[58] The market value of the interest in the mining tenement.
[59] The cash payment.
[60] The amount of $1,100 is deducted because, upon the exercise of the right to acquire the interest in the mining tenement, the consideration for the exploration benefit is limited to any additional consideration that is provided (see paragraph 9-17(1)(a) of the GST Act).

Farmor – cash basis **All legislative references are to the GST Act**	**Farmor – non-cash basis** **All legislative references are to the GST Act**
$8,900 GST payable Under the legislative instrument, the GST payable is attributable to tax period 1, year 4 and not the earlier tax periods in which the exploration benefit is received. $1,000 GST payable Under the basic rules (paragraph 29-5(2)(a)), the GST payable is attributable to tax period 4, year 3 as this is the tax period in which the monetary consideration is received.	$8,900 GST payable $1,000 GST payable Under the legislative instrument, the GST payable is attributable to tax period 4, year 3 and not tax period 1, year 1, which is the first tax period in which any of the exploration benefit commenced being received.
$8,900 input tax credit Under the basic rules (paragraph 29-10(2)(a)), the input tax credit is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. all of the consideration) is provided by the farmor. The farmor would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmee to claim an input tax credit in this tax period.	$8,900 input tax credit Under the basic rules (paragraph 29-10(1)(b)), the input tax credit is attributable to tax period 4, year 3 if the farmee issues the farmor with an invoice in this tax period. If not, the input tax credit is attributable (paragraph 29-10(1)(a)) to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. any of the consideration) is provided by the farmor. The farmor would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmee to claim an input tax credit in either tax period.
Net outcome Legislative instrument – $8,900 GST payable in tax period 1, year 4 Basic rules – $8,900 input tax credit claimable in tax period 1, year 4 provided a tax invoice is held in that tax period Basic rules – $1,000 GST payable in tax period 4, year 3	*Net outcome* Legislative instrument – $8,900 GST payable in tax period 4, year 3 Legislative instrument – $1,000 GST payable in tax period 4, year 3 Basic rules – $8,900 input tax credit claimable in tax period 4, year 3; or tax period 1, year 4; provided a tax invoice is held in that tax period

Supply of an exploration benefit and acquisition of the interest in the mining tenement by the farmee

GST payable

99. The supply of the exploration benefit is a taxable supply if the requirements of section 9-5 of the GST Act are satisfied. The consideration for that supply is the interest in the mining tenement provided by the farmor to the extent that the market value of that interest exceeds any payments (see paragraph 29(ii) of this Ruling) made to, or on behalf of, the farmor by the farmee for that interest.

100. The basic attribution rules under Division 29 of the GST Act apply to the attribution of GST payable.

101. If a farmee accounts for GST on a non-cash basis, the GST payable by the farmee is attributable to the tax period in which the interest in the mining tenement is received by the farmee, unless the farmee issues an invoice to the farmor before this. The earliest tax period in which a farmee could issue an invoice to the farmor is the tax period in which the farmee, having completed the earn-in requirements, exercises the right to acquire the interest in the mining tenement. If an invoice is not issued, the GST payable is attributable to the tax period in which the interest in the mining tenement is transferred from the farmor to the farmee.

102. If a farmee accounts for GST on a cash basis the GST payable by the farmee is attributable to a tax period to the extent that consideration is received in that tax period. On this basis, the GST payable is attributable to the tax period in which the interest in the mining tenement is transferred to the farmee.

Input tax credits

103. The farmee is also entitled to an input tax credit for the acquisition of the interest in the mining tenement if it is a creditable acquisition.

104. Under the *A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2012* the attribution of an input tax credit for a creditable acquisition of the interest in the mining tenement occurs as follows:

(i) *if the farmee accounts for GST on a non-cash basis* – the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest; and

(ii) *if the farmee accounts for GST on a cash basis* – the input tax credit for a creditable acquisition of an interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire that interest to the extent of any consideration provided in that tax period or an earlier tax period for that acquisition.

105. The attribution rules in the legislative instrument only override the basic attribution rules and the special rules in Chapter 4 of the GST Act to the extent of any inconsistency and only to the extent provided for in the legislative instrument. If a cash basis farmee provides further consideration upon the transfer of the interest in the mining tenement, the input tax credit with respect to that further consideration, is attributable in the tax period in which the consideration is provided according to the basic attribution rules.

106. The tax period in which the farmee exercises the right to acquire that interest is the earliest tax period in which the farmor could issue the farmee with a tax invoice. The farmee must hold a tax invoice to claim an input tax credit.

107. The legislative instrument ensures that the four year time limit[61] for claiming input tax credits does not run from a tax period when the farmee could not claim input tax credits as at that time there is no certainty as to making an acquisition, and thus a creditable acquisition, and the farmor can not issue a tax invoice due to a lack of certainty as to any obligation to make a supply.

Example 2 – farmee's attribution of GST payable and input tax credits

108. Following on from Example 1 at paragraph 95 of this Ruling, the following table shows the outcome for a farmee.

Farmee – cash basis **All legislative references are to the GST Act**	**Farmee – non-cash basis** **All legislative references are to the GST Act**
$8,900 GST payable Under the basic rules (paragraph 29-5(2)(a)), the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. all of the consideration) is received by the farmee.	$8,900 GST payable Under the basic rules (paragraph 29-5(1)(a)), the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. any of the consideration) is received by the farmee. However, if the farmee issues an invoice in an earlier tax period, for example, in tax period 4, year 3, the GST payable is attributable to this earlier tax period (paragraph 29-5(1)(b)).
$9,900[62] input tax credit Under the legislative instrument, the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply.	$9,900 input tax credit Under the legislative instrument, the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply.

[61] Division 93 of the GST Act.
[62] That is, $8,900 plus $1,000.

Farmee – cash basis **All legislative references are to the GST Act**	**Farmee – non-cash basis** **All legislative references are to the GST Act**
Net outcome Basic rules – $8,900 GST payable in tax period 1, year 4 Legislative instrument – $9,900 input tax credit claimable in tax period 4, year 3 provided a tax invoice is held in that tax period	*Net outcome* Basic rules – $8,900 GST payable in tax period 1, year 4; or, tax period 4, year 3 Legislative instrument- $9,900 input tax credit claimable in tax period 4, year 3 provided a tax invoice is held in that tax period

Supply of exploration benefit but no supply of the interest in the mining tenement

109. If there is no supply of the interest in the mining tenement by the farmor to the farmee, neither the farmor nor the farmee have a GST liability nor any entitlement to an input tax credit in relation to either the interest in the mining tenement or the exploration benefit. This is based on the characteristics as set out in the Ruling that any monetary payments to the farmor for the supply of the interest in the mining tenement are made upon exercise of the right to acquire the interest or at the time of the transfer of the interest.

110. To the extent that any GST or input tax credits have been accounted for in an earlier tax period the farmor, or the farmee, as appropriate, may have an adjustment event. An adjustment event may arise if the farmee exercises its right to acquire the interest in the mining tenement but the transfer of that interest ultimately does not occur because necessary approval (for example, Ministerial approval) is not given to the transfer.

Mining information

111. If the parties have identified consideration provided by the farmee as being for mining information shared by the farmor with the farmee on entering into the agreement, that sharing is treated as a supply by the farmor separate from the supply of the interest in the mining tenement. The consideration for the interest in the mining tenement would not include any consideration identified for the mining information.

112. The farmor makes a taxable supply of that mining information and it is a creditable acquisition for the farmee. Assuming total consideration is known, GST payable by the farmor, and any input tax credits able to be claimed by the farmee, are attributable under the basic attribution rules.

GST going concern

113. Paragraph 195 of Goods and Services Tax Ruling GSTR 2002/5[63] explains that it is possible for a joint venturer[64] entity to make a GST-free 'supply of a going concern', including when part of the enterprise conducted by the joint venturer is supplied. This is providing all of the requirements of section 38-325 of the GST Act, as explained in GSTR 2002/5, are satisfied.

114. If a supply by a joint venturer farmor (which includes the supply of the interest in the mining tenement) is the supply of a going concern that is a GST-free supply under section 38-325 of the GST Act, the farmee will not have any input tax credits to claim and the farmor will have no GST payable in respect of that supply. However, GST is payable by the farmee in respect of its supply of the exploration benefit to the farmor and the farmor may be entitled to input tax credits.

Further Examples – income tax and GST

Example 3 – farmor receives a cash payment and an exploration benefit

115. The facts for this example are as follows:

- Farmor Co holds a 100% interest in a mining tenement;
- The mining tenement is at the exploration stage and has no adjustable value for income tax purposes (that is, a deduction has previously been claimed in full for the cost of the mining tenement by Farmor Co under subsection 40-25(1) of the ITAA 1997 applying subsection 40-80(1) of the ITAA 1997);
- Farmor Co and Farmee Co enter into a deferred transfer farm-out agreement. The parties are dealing with each other at arm's length. Farmor Co agrees to transfer a 60% interest in the mining tenement to Farmee Co under the agreement, leaving Farmor Co with a 40% interest;
- Farmor Co shares mining information with Farmee Co, but separate consideration is not identified for that element of the agreement;

[63] Goods and Services Tax Ruling *GSTR 2002/5 Goods and services tax: when is a 'supply of a going concern' GST-free?*
[64] For further explanation concerning joint venture arrangements see Goods and Services Tax Ruling *GSTR 2004/2 Goods and services tax: what is a joint venture for GST purposes?*

- Farmee Co is required to pay Farmor Co $70,000 (GST-exclusive) for the grant of exclusive use and access rights and $1,000 (GST-exclusive) for the grant of the right to acquire an interest in the mining tenement upon entering into the agreement;
- Farmee Co is also required to meet all fees, rent, rates and other charges while the agreement is on foot in return for the grant of exclusive use and access rights (assume that this is $100,000 (GST-exclusive) for the purposes of showing Farmor Co's and Farmee Co's tax consequences);
- Farmee Co is required to carry out initial exploration to the GST-exclusive value of $150,000 (mandatory exploration);
- Farmee Co must carry out further exploration to the GST-exclusive value of $1,000,000 (optional exploration) over the earn-in period of 3 years if it is to earn an interest in the mining tenement. That is, the total exploration is to the GST-exclusive value of $1,150,000;
- Farmee Co is required to share any mining information with Farmor Co;
- Farmee Co may withdraw from the agreement by giving notice to Farmor Co at any time during the earn-in period once the mandatory exploration is completed provided the mining tenement is in good order at the time of the notice. If Farmee Co gives such notice to withdraw, it will not earn any interest in the mining tenement; and
- The market value of the 60% interest in the mining tenement is $500,000 (GST-exclusive). This market value is based on all the facts and surrounding circumstances including the terms of the agreement and what is known about the mining tenement at the time of entry into the agreement. It is reasonable to assume, therefore, that the market value of the exploration benefit provided to Farmor Co is $499,000 (GST-exclusive).[65]

116. The amounts and values in this example are used purely to illustrate the calculations required under this Ruling and should not be taken to imply anything about how to work out the value of things in particular cases.

---

[65] Worked out as $500,000 market value of the 60% interest in the mining tenement reduced by the $1,000 cash payment that relates to the acquisition of that interest in the mining tenement.

117. The income tax consequences for Farmor Co and Farmee Co are summarised respectively in Tables 1 and 2 that follow. It is assumed that:

- if mention is made of subsection 40-730(1) of the ITAA 1997 – all of the other requirements of subsection 40-730(1) of the ITAA 1997 are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply; and
- if mention is made of any other provision – all of the requirements of that provision are satisfied.

Table 1 – Income Tax – Farmor Co

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 unless otherwise stated and all amounts are GST-exclusive**	**Timing**
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmor Co grants Farmee Co the right to acquire a 60% interest in the mining tenement for a payment of $1,000.	$1,000 subsection 102-5(1) CGT event D2 happens under section 104-40. Capital gain equals $1,000.[66] (see paragraphs 39 and 40)	When the farm-out agreement is entered into.
2 – Farmor Co grants Farmee Co exclusive use and access rights for a payment of $70,000 and further payments of up to $100,000.	$70,000 + up to $100,000 section 6-5 The receipt of the payments is treated on revenue account and is assessable under section 6-5. (see paragraph 43)	$70,000 – when the farm-out agreement is entered into. Up to $100,000 – as and when the income is derived.

[66] A capital gain is made that is equal to the capital proceeds ($1,000) less the expenditure incurred in granting the right. This assumes that the expenditure incurred in granting the right is nil. Any capital gain made under CGT event D2 is subsequently disregarded to the extent that the right is exercised and the interest in the mining tenement is transferred to Farmee Co.

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 unless otherwise stated and all amounts are GST-exclusive**	**Timing**
3 – Expenditure is incurred by Farmor Co as holder of the mining tenement for fees, rents, rates and other outgoings relating to the maintenance of the mining tenement (effectively met by Farmee Co as part of the farm-out arrangement).	Up to ($100,000) section 8-1 (see paragraph 45)	When the expenditure is incurred.
Summary	*Net capital gain = $1,000* *Net revenue income = $70,000*	
Transfer of the interest in the mining tenement		
4 – Farmor Co transfers the 60% interest in the mining tenement as Farmee Co completes its earn-in obligations and exercises the right to acquire an interest in the mining tenement. Farmor Co receives an exploration benefit of $499,000 and the $1,000 cash payment in relation to the grant of the right. Any capital gain or capital loss made on the grant of the right (CGT event D2) is subsequently disregarded (see paragraphs 57 and 58).	*CGT outcome* ($1,000) reversal of the amount included in an earlier income year. (see paragraph 57) *UCA outcome* $1,000 under item 1 of the table in paragraph 40-305(1)(b) $499,000 under item 4 of the table in paragraph 40-305(1)(b) (see paragraphs 51 and 58)	When Farmee Co exercises the right to acquire the interest in the mining tenement on the basis that Farmee Co begins to hold the interest at that time.

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 unless otherwise stated and all amounts are GST-exclusive	Timing
5 – Farmor Co expends the 60% interest in the mining tenement partly in return for the exploration benefit.	($499,000) subsection 40-730(1) (see paragraphs 52 to 56)	When Farmee Co exercises the right to acquire the interest in the mining tenement on the basis that Farmor Co has an obligation to transfer the interest at that time.
Summary	*($1,000) amendment in relation to CGT event D2 in an earlier year* *$1,000 – current year*	

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 unless otherwise stated and all amounts are GST-exclusive	Timing
Exploration benefit provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $100,000 in year 1 and $50,000 in year 2[67] over the 1½ years that the agreement was on foot.		
6 – Farmee Co notifies Farmor Co that it is withdrawing from the agreement.	Non-cash business benefit $100,000 in year 1. Non-cash business benefit $50,000 in year 2. Otherwise deductible amount is $100,000 in year 1 and $50,000 in year 2. Therefore, no amount to be included in Farmor Co's assessable income. Section 21 and subsections 21A(1), 21A(2) and 21A(3) of the ITAA 1936. (see paragraphs 74 to 76) *Note: the outcome from this event is the alternative outcome to the outcomes from events 4 and 5.*	

[67] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.

Table 2 – Income Tax – Farmee Co

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive**	**Timing**
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmee Co acquires a CGT asset being the right to acquire the interest.	Cost base of $1,000. (see paragraph 41) [If the $1,000 is not deductible, capital loss under CGT event C2 equal to $1,000 upon ending of the right.] (see paragraph 42)	When the farm-out agreement is entered into. [In the income year in which the right ends.]
2 – Farmee Co pays for the rights to exclusive use and access.	($70,000) + up to ($100,000) Section 8-1 (see paragraph 46) [If the $170,000 is not deductible, capital loss under CGT event C2 equal to $170,000 upon ending of the rights.] (see paragraph 47)	When the expenditure is incurred. [In the income year in which the rights end.]
Summary	*($170,000)* [Capital loss of $171,000 upon ending of both rights if $171,000 is not deductible.]	

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive	Timing
Transfer of the interest in the mining tenement		
3 – Farmee Co has already made a cash payment of $1,000 for the right to acquire the interest. Farmee Co also provides an exploration benefit of $499,000 to Farmor Co in return for Farmor Co transferring a 60% interest in the mining tenement to Farmee Co.	($1,000) under item 1 of the table in paragraph 40-185(1)(b) ($499,000) under item 4 of the table in paragraph 40-185(1)(b) $500,000 is the first element of cost of the interest in the mining tenement and immediately deductible if Farmee Co's 60% interest is first used for exploration or prospecting: subsections 40-25(1) and 40-80(1) (see paragraphs 64 to 68)	When Farmee Co's 60% interest in the mining tenement is first used for exploration or prospecting if it is immediately deductible. Alternatively, when the interest in the mining tenement starts to decline in value under subsection 40-25(1). (see paragraphs 65 to 68)
4 – Farmee Co provides an exploration benefit (on revenue account) to Farmor Co for which Farmee Co earns part of its 60% interest in the mining tenement.	$499,000 section 6-5 $499,000 of the interest in the mining tenement earned by Farmee Co is attributable to its provision of the exploration benefit. (see paragraphs 70 and 71)	When Farmee Co exercises the right to acquire the interest in the mining tenement.

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive	Timing
5 – Farmee Co incurs exploration expenditure in the course of undertaking the exploration it committed to under the agreement.	($1,150,000) subsection 40-730(1) or section 8-1 (see paragraphs 69 and 72)	When the expenditure is incurred.
Summary	*($1,151,000)*	
Exploration benefit provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $100,000 in year 1 and $50,000 in year 2[68] over the 1½ years that the agreement was on foot.		
6 – Farmee Co incurs exploration expenditure while the agreement is on foot.	($345,000) subsection 40-730(1) or section 8-1 (see paragraphs 77 to 79)	When the expenditure is incurred.
7 – Farmee Co's right to acquire the interest ends.	($1,000) Capital loss under CGT event C2 equal to capital proceeds of zero less cost base of $1,000 upon ending of the right.[69] (see paragraph 42)	In the income year in which the right ends.
Summary	*($345,000)* allowable deduction *($1,000)* capital loss *Note: The outcomes from events 6 and 7 are the alternative outcomes to the outcomes from events 3, 4 and 5.*	

[68] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.
[69] This reflects the outcome in event 1 where the $1,000 is not deductible.

118. The GST consequences for Farmor Co and Farmee Co are summarised in Table 3 that follows. It assumes that:

- Farmor Co and Farmee Co are each registered for GST and account for GST on a non-cash basis; and
- the supplies are taxable supplies and the acquisitions are creditable acquisitions for a fully creditable purpose.

Table 3 – GST outcomes for Farmor Co and Farmee Co

Event	**GST payable/input tax credits (ITCs)**	**Attribution to a tax period** (non-cash basis)
Upon entry into the agreement and before the right to acquire the interest in the mining tenement is exercised		
1 – Farmor Co makes a taxable supply of the right to acquire an interest in the mining tenement.	GST payable of $100 ($1,000 x 10% = $100; GST-inclusive price of $1,100) (see paragraphs 83 to 86)	When an invoice is issued or any of the consideration is received, whichever is earlier.
2 – Farmor makes a taxable supply of the exclusive use and access rights.	GST payable of $7,000 + up to $10,000 ($70,000 x 10% = $7,000; GST-inclusive price of $77,000) ($100,000 x 10% = $10,000; GST-inclusive price of $110,000) (see paragraphs 83 to 86)	When an invoice is issued or any of the consideration is received, whichever is earlier; or according to the legislative determination if total consideration is not known (PAR 2000/1).
3 – Farmee Co makes a creditable acquisition of the right (option) to acquire an interest in the mining tenement.	ITC entitlement of $100 ($1/11^{th}$ of $1,100 GST-inclusive) (see paragraphs 83 to 86)	When an invoice is issued or any of the consideration is provided, whichever is earlier.

Event	GST payable/input tax credits (ITCs)	Attribution to a tax period (non-cash basis)
4 – Farmee Co makes a creditable acquisition of exclusive use and access rights.	ITCs claimable of $7,000 + up to $10,000 1/11th of $77,000 GST-inclusive) + up to (1/11th of $110,000 GST-inclusive) (see paragraphs 83 to 86)	When an invoice is issued or any of the consideration is provided, whichever is earlier; or according to the legislative determination if total consideration is not known (PAR 2000/1). Farmee Co must also hold a tax invoice.
Transfer of the interest in the mining tenement		
5 – Farmor Co makes a taxable supply of the interest in the mining tenement (additional consideration[70] is the exploration benefit).	GST payable of $49,900 ($499,000 x 10% = $49,900; GST-inclusive price of $548,900) (see paragraphs 87 to 90)	When Farmee Co exercises the right to acquire the interest in the mining tenement. See Determination mentioned at paragraph 88.
6 – Farmor Co makes a creditable acquisition of the exploration benefit (consideration is the interest in the mining tenement).	ITC entitlement of $49,900 (1/11th of $548,900 GST-inclusive)(see paragraphs 91 to 94)	When an invoice is issued or any of the consideration is provided, whichever is earlier. Farmor Co must also hold a tax invoice.
7 – Farmee Co makes a taxable supply of the exploration benefit to Farmor co.	GST payable of $49,900 ($499,000 x 10% = $49,900; GST-inclusive price of $548,900) (see paragraphs 99 to 102)	When an invoice is issued or any of the consideration is received, whichever is earlier.

[70] Subsection 9-17(1) of the GST Act.

<table>
<tr><th>Event</th><th>GST payable/input tax credits (ITCs)</th><th>Attribution to a tax period (non-cash basis)</th></tr>
<tr><td>8 – Farmee Co makes a creditable acquisition of the interest in the mining tenement (consideration is the exploration benefit).</td><td>ITC entitlement of $49,900
(1/11th of $548,900 GST-inclusive)
(see paragraphs 103 to 107)</td><td>When Farmee Co exercises the right to acquire the interest in the mining tenement and holds a tax invoice. See Determination mentioned at paragraph 104.</td></tr>
<tr><td>Summary</td><td colspan="2">Farmor Co
GST payable of $7,100 and up to $10,000
May also be GST payable of $49,900 and entitled to an ITC of $49,900
Farmee Co
Entitled to ITCs of $7,100 and up to $10,000.
May also be entitled to an ITC of $49,900 and have GST payable of $49,900</td></tr>
<tr><td colspan="3">Exploration benefit provided but no transfer of any interest in the mining tenement. Assume Farmee Co has spent $345,000 of its $1,150,000 and the pro-rata exploration benefit is $150,000[71] (approximately) over the 1½ years that the agreement was on foot.</td></tr>
<tr><td>9 – Farmor Co does not transfer a 60% interest in the mining tenement to Farmee Co.</td><td><u>Farmor Co</u>
No further GST consequences as there is no supply of the interest in the mining tenement by Farmor Co.
<u>Farmee Co</u>
No further GST consequences as there is no acquisition of the interest in the mining tenement.
(see paragraphs 109 and 110)</td><td></td></tr>
</table>

[71] For example, a pro-rata of $345,000/$1,150,000 x $500,000 = $150,000.

Example 4 – farmor receives a cash payment and an exploration benefit – the interest in the mining tenement is transferred to the farmee in two tranches

119. The facts for this example are as follows:

- Farmor Co holds a 100% interest in a mining tenement;
- The mining tenement is at the exploration stage and has no adjustable value for income tax purposes (that is, a deduction has previously been claimed in full for the cost of the mining tenement by Farmor Co under subsection 40-25(1) of the ITAA 1997 applying subsection 40-80(1) of the ITAA 1997);
- Farmor Co and Farmee Co enter into a deferred transfer farm-out agreement. The parties are dealing with each other at arm's length. Farmee Co has the opportunity to earn a 30% interest and then a further 30% interest to potentially give it a total 60% interest, leaving Farmor Co with a 40% interest;
- Farmor Co shares mining information with Farmee Co, but separate consideration is not identified for that element of the agreement;
- Farmee Co is required to pay Farmor Co $70,000 (GST-exclusive) for the grant of exclusive use and access and $1,000 (GST-exclusive) for the grant of the right to acquire both 30% interests upon entering into the agreement;
- Farmee Co is also required to meet all fees, rent, rates and other charges while the agreement is on foot in return for the grant of exclusive use and access rights (assume that this is $100,000 (GST-exclusive) for the purposes of showing Farmor Co's and Farmee Co's tax consequences);
- Farmee Co is required to carry out initial exploration to the GST-exclusive value of $150,000 (mandatory exploration);
- Farmee Co must carry out further exploration work to the GST-exclusive value of $1,000,000 (optional exploration) over the earn-in period of 3 years if it is to earn its first tranche 30% interest in the mining tenement;

- Farmee Co must carry out further exploration to the GST-exclusive value of $500,000 (optional exploration) over a further 2 year period. On completion of the further optional exploration, Farmee Co is entitled to request a transfer of the second tranche 30% interest in the mining tenement, bringing its total interest to 60%;
- The total exploration under the agreement is $1,650,000 (GST-exclusive);
- Farmee Co is required to share any mining information with Farmor Co;
- Farmee Co may withdraw from the agreement by giving notice to Farmor Co at any time during the earn-in period once the mandatory exploration is completed provided the mining tenement is in good order at the time of the notice. If Farmee Co gives such notice to withdraw, it will not earn either of the 30% interests, or the second 30% interest, in the mining tenement depending on when such notice is given;
- The market value of the total 60% interest in the mining tenement is $500,000 (GST-exclusive). This market value is based on all the facts and surrounding circumstances including the terms of the agreement and what is known about the mining tenement at the time of entry into the farm-out agreement. It is reasonable to assume, therefore, that the market value of the exploration benefit provided to Farmor Co is $499,000 (GST-exclusive);[72]
- The first and second tranches of the interest in the mining tenement were transferred from Farmor Co to Farmee Co.

120. The amounts and values in this example are used purely to illustrate the calculations required under this Ruling and should not be taken to imply anything about how to work out the value of things in particular cases.

121. The income tax consequences for Farmor Co and Farmee Co are summarised respectively in Tables 4 and 5 that follow. It is assumed that:

- if mention is made of subsection 40-730(1) of the ITAA 1997 – all of the other requirements of subsection 40-730(1) of the ITAA 1997 are satisfied and subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply; and

[72] Worked out as $500,000 market value of the 60% interest in the mining tenement reduced by the $1,000 cash payment that relates to the acquisition of that tenement.

- if mention is made of any other provision - all of the requirements of that provision are satisfied.

Table 4 – Income Tax – Farmor Co

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive**	**Timing**
Upon entry into the agreement and before the right to acquire any interest in the mining tenement is exercised		
1 – Farmor Co grants Farmee Co the right to acquire up to a 60% interest for a payment of $1,000.	$1,000 subsection 102-5(1) CGT event D2 happens under section 104-40. Capital gain equals $1,000.[73]. (see paragraphs 39 and 40)	When the farm-out agreement is entered **into**.
2 – Farmor Co grants Farmee Co exclusive use and access rights for a payment of $70,000 and further payments of up to $100,000.	$70,000 + up to $100,000 section 6-5 The receipt of the payments is treated on revenue account and is assessable under section 6-5. (see paragraph 43)	$70,000 – when the farm-out agreement is entered into. Up to $100,000 – as and when the income is derived.
3 – Expenditure is incurred by Farmor Co as holder of the tenement for fees, rents, rates and other outgoings relating to the maintenance of the tenement (effectively met by Farmee Co as part of the farm-out agreement).	Up to ($100,000) section 8-1 (see paragraph 45)	When the expenditure is incurred.
Summary	*Net capital gain = $1,000* *Net revenue income = $70,000*	

[73] A capital gain is made that is equal to the capital proceeds ($1,000) less the expenditure incurred in granting the right. This assumes that the expenditure incurred in granting the right is nil. Any capital gain made under CGT event D2 is subsequently disregarded to the extent that the right is exercised and the interest in the mining tenement is transferred to Farmee Co.

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive**	**Timing**
Transfer of the first tranche 30% interest in the mining tenement		
4 – Farmor Co transfers the first tranche 30% interest in the mining tenement as Farmee Co completes the first tranche earn-in obligations and exercises the right to acquire that tranche. Farmor Co receives an exploration benefit and cash payment in relation to the grant of the right, proportionate to the percentage interest transferred (i.e. 50% of the total interest to potentially be transferred). Any capital gain or capital loss made on the grant of the right (CGT event D2) is subsequently disregarded (see paragraphs 57 and 58).	*CGT outcome* ($500) reversal of the amount included in an earlier income year (see paragraph 57) *UCA outcome* $500 under item 1 of the table in paragraph 40-305(1)(b) $249,500 under item 4 of the table in paragraph 40-305(1)(b). (see paragraphs 51 and 58)	When Farmee Co exercises the right to acquire the interest in the mining tenement for the first tranche on the basis that Farmee Co begins to hold the interest at that time.
5 – Farmor Co expends the first tranche 30% interest in the mining tenement partly in return for the proportionate share of the exploration benefit relating to that 30% interest.	($249,500) subsection 40-730(1) (see paragraphs 52 to 56)	When Farmee Co exercises the right to acquire the interest in the mining tenement for the first tranche on the basis that Farmor Co has an obligation to transfer the interest at that time.
Summary	*($500) amendment in relation to CGT event D2 in an earlier year* *$500 – current year*	

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive	Timing
Transfer of the second tranche 30% interest in the mining tenement		
6 – Farmor Co transfers the second tranche 30% interest in the mining tenement as Farmee Co completes the second tranche earn-in obligations and exercises the right to acquire that tranche. Farmor Co receives the remaining proportionate share of the exploration benefit and cash payment in relation to the grant of the right. The CGT consequences are as for event 4.	***CGT outcome*** ($500) reversal of the amount included in an earlier income year (see paragraph 57) ***UCA outcome*** $500 under item 1 of the table in paragraph 40-305(1)(b) $249,500 under item 4 of the table in paragraph 40-305(1)(b). (see paragraphs 51 and 58)	When Farmee Co exercises the right to acquire the interest in the mining tenement for the second tranche on the basis that Farmee Co begins to hold the interest at that time.
7 – Farmor Co expends the second tranche 30% interest in the mining tenement partly in return for the proportionate share of the exploration benefit relating to that 30% interest.	($249,500) subsection 40-730(1) (see paragraphs 52 to 56)	When Farmee Co exercises the right to acquire the interest in the mining tenement for the second tranche on the basis that Farmor Co has an obligation to transfer the interest at that time.
Summary	*($500) amendment in relation to CGT event D2 in an earlier year* *$500 – current year*	

Table 5 – Income Tax – Farmee Co

Event	**Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive**	**Timing**
Upon entry into the agreement and before the right to acquire any interest in the mining tenement is exercised		
1 – Farmee Co acquires a CGT asset being the right to acquire up to a 60% interest.	Cost base of $1,000 (see paragraph 41) [If the $1,000 is not deductible, capital loss under CGT event C2 equal to $1,000 upon ending of the right] (see paragraph 42)	When the farm-out agreement is entered into. [In the income year in which the right ends.]
2 – Farmee Co pays for the rights to exclusive use and access.	($70,000) + up to ($100,000) section 8-1 (see paragraph 46) [If the $170,000 is not deductible, capital loss under CGT event C2 equal to $170,000 upon ending of the rights.] (see paragraph 47)	When the expenditure is incurred. [In the income year in which the rights end.]
Summary	*($170,000)* [Capital loss of $171,000 upon ending of both rights if $171,000 is not deductible.]	

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive	Timing
Transfer of the first tranche 30% interest in the mining tenement		
3 – Farmee Co completes the first tranche earn-in obligations and exercises the right to acquire that tranche. The exploration benefit and cash payment is proportionate to the percentage interest transferred.	($500) under item 1 of the table in paragraph 40-185(1)(b) ($249,500) under item 4 of the table in paragraph 40-185(1)(b) $250,000 is the first element of cost of the interest in the mining tenement and immediately deductible if Farmee Co's 30% interest is first used for exploration or prospecting: subsections 40-25(1) and 40-80(1) (see paragraphs 64 to 68)	When Farmee Co's 30% interest in the mining tenement is first used for exploration or prospecting if it is immediately deductible. Alternatively, when the interest in the mining tenement starts to decline in value under subsection 40-25(1). (see paragraphs 65 to 68)
4 – Farmee Co provides an exploration benefit (on revenue account) to Farmor Co for which Farmee Co earns its first 30% interest in the mining tenement.	$249,500 Section 6-5. $249,500 of the interest in the mining tenement earned by Farmee Co is attributable to its provision of the exploration benefit. (see paragraphs 70 and 71)	When Farmee Co exercises the right to acquire the interest in the mining tenement.

Event	Assessable/ (Deductible) all legislative references are to the ITAA 1997 and all amounts are GST-exclusive	Timing
Transfer of the second tranche 30% interest in the mining tenement		
5 – Farmee Co completes the second tranche earn-in obligations and exercises the right to acquire that tranche. The exploration benefit and cash payment is proportionate to the percentage interest transferred.	($500) under item 1 of the table in paragraph 40-185(1)(b) ($249,500) under item 4 of the table in paragraph 40-185(1)(b) $250,000 is the first element of cost of the interest in the mining tenement and immediately deductible if Farmee Co's 30% interest is first used for exploration or prospecting: subsections 40-25(1) and 40-80(1) (see paragraphs 64 to 68)	When Farmee Co's 30% interest in the mining tenement is first used for exploration or prospecting if it is immediately deductible. Alternatively, when the interest in the mining tenement starts to decline in value under subsection 40-25(1). (see paragraphs 65 to 68)
6 – Farmee Co provides an exploration benefit (on revenue account) to Farmor Co for which Farmee Co earns its second 30% interest in the mining tenement.	$249,500 section 6-5 $249,500 of the interest in the mining tenement earned by Farmee Co is attributable to its provision of the exploration benefit. (see paragraphs 70 and 71)	When Farmee Co exercises the right to acquire the interest in the mining tenement. (see paragraph 71)
7 – Farmee Co incurs exploration expenditure in the course of undertaking the exploration it committed to under the agreement.	($1,650,000) subsection 40-730(1) or section 8-1 (see paragraphs 69 and 72)	As and when the expenditure is incurred.
Summary	*($1,651,000)*	

GST outcomes for Farmor Co and Farmee Co

122. For GST purposes, each 30% tranche of the interest in the mining tenement is a separate supply. The same principles illustrated in Example 3 (Table 3, paragraph 118) of this Ruling apply for the calculation of GST payable and input tax credits for both Farmor Co and Farmee Co.

Date of effect

123. This Ruling applies to a deferred transfer farm-out arrangement[74] that is:

(a) in relation to the Commissioner's views on the application of the income tax provisions – entered into after 24 August 2011 but no later than 7:30 pm, by legal time in the Australian Capital Territory, on 14 May 2013, if the farmor started to hold the mining tenement that is the subject of the arrangement on or after 1 July 2011, and

(b) in relation to the Commissioner's views on the application of the GST provisions – entered into after 24 August 2011.

124. For the purposes of the income tax provisions:

(a) Taxation Ruling IT 2378 is relevant if the farmor started to hold the mining tenement before 1 July 2001; and

(b) Refer to the 'Deferred transfer farm-out arrangements' fact sheet for guidance on the treatment of a deferred transfer farm-out arrangement that satisfies subsection 40-1100(1) of the *Income Tax Assessment Act 1997* and is entered into after 7.30 pm, by legal time in the Australian Capital Territory, on 14 May 2013.

Commissioner of Taxation
18 April 2012

[74] It must be a deferred transfer farm-out arrangement of the type covered by this Ruling.

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.

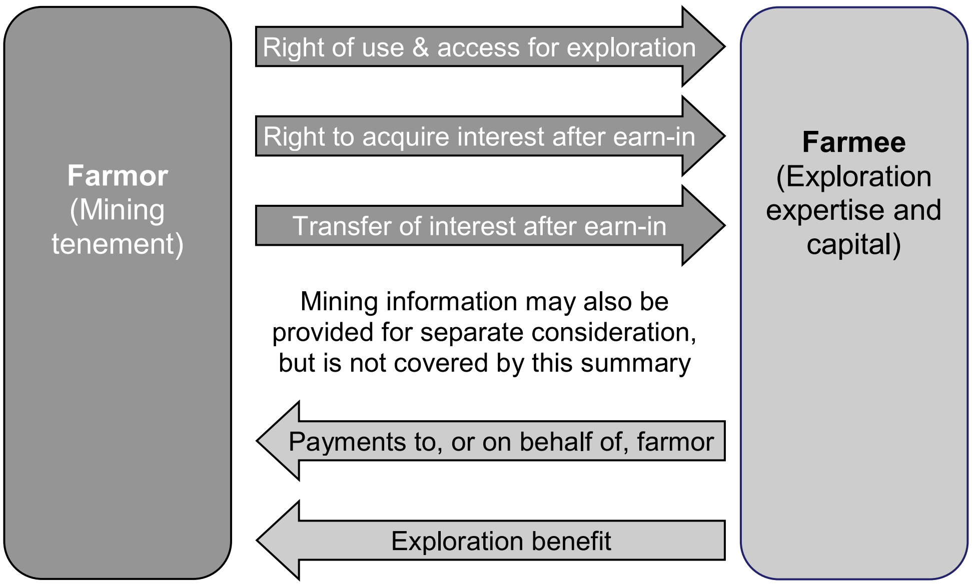
125. The Explanation section of this Ruling is set out in three Parts:

- *Part A* has diagrams summarising the Commissioner's views on the significant issues dealt with in this Ruling (paragraphs 126 to 127 of this Ruling);
- *Part B* further explains the Commissioner's approach to certain key issues, which are relevant for the application of both the income tax and GST laws to deferred transfer farm-out arrangements (paragraphs 128 to 154 of this Ruling); and
- *Part C* provides further explanation of the application of certain income tax provisions to deferred transfer farm-out arrangements (paragraphs 155 to 175 of this Ruling).

Part A – Diagrammatic representation of certain key issues

126. The following diagram illustrates the character of the things typically provided by the farmor and the farmee.

Diagram 1 – characterisation of a deferred transfer farm-out arrangement



127. The following diagrams illustrate the usual income tax and GST consequences of a deferred transfer farm-out arrangement.

Diagram 2 – usual income tax and GST consequences for right of use and access for exploration

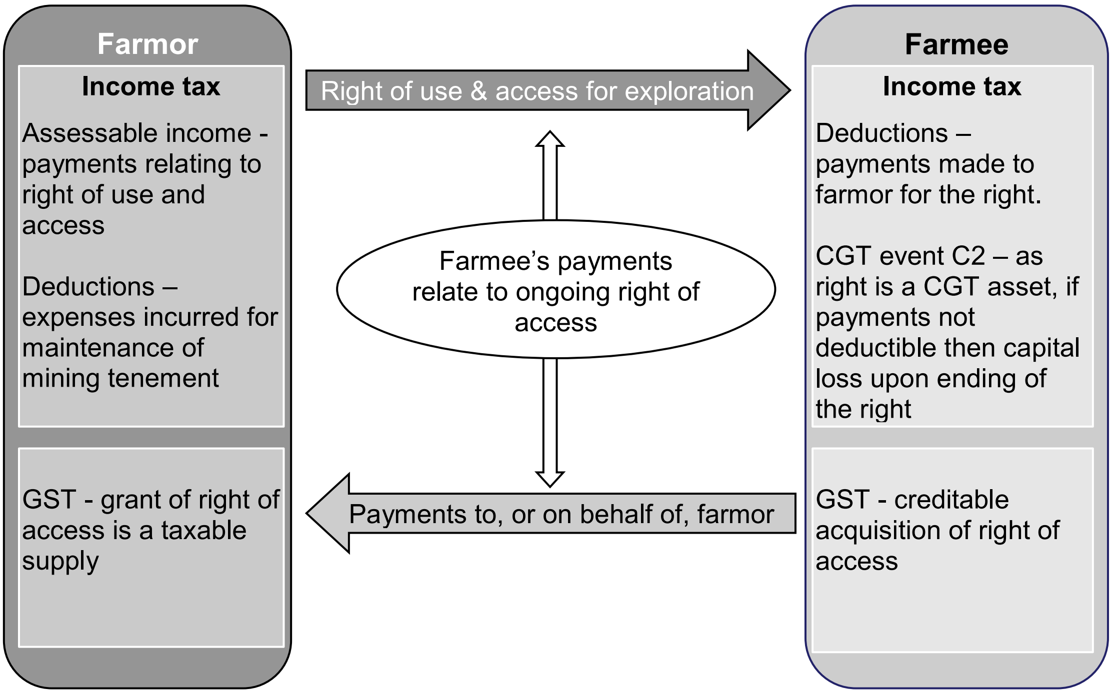


Diagram 3 – usual income tax and GST consequences for the right to acquire the interest in the mining tenement after earn-in

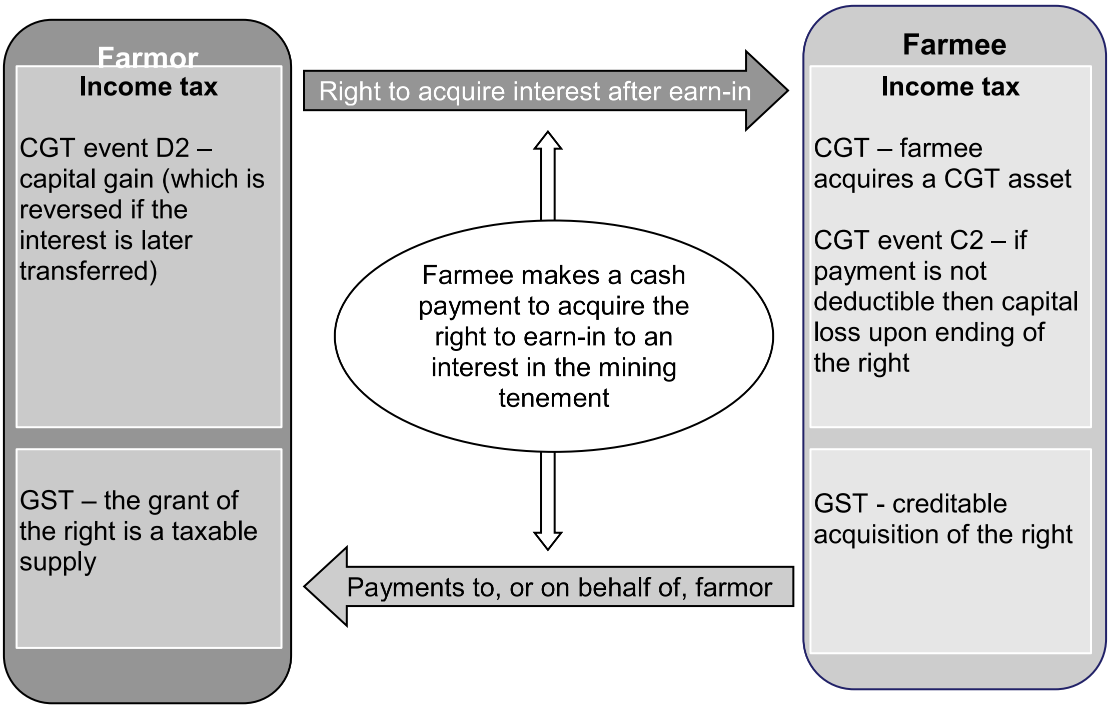


Diagram 4 – usual income tax and GST consequences for the transfer of the interest in the mining tenement

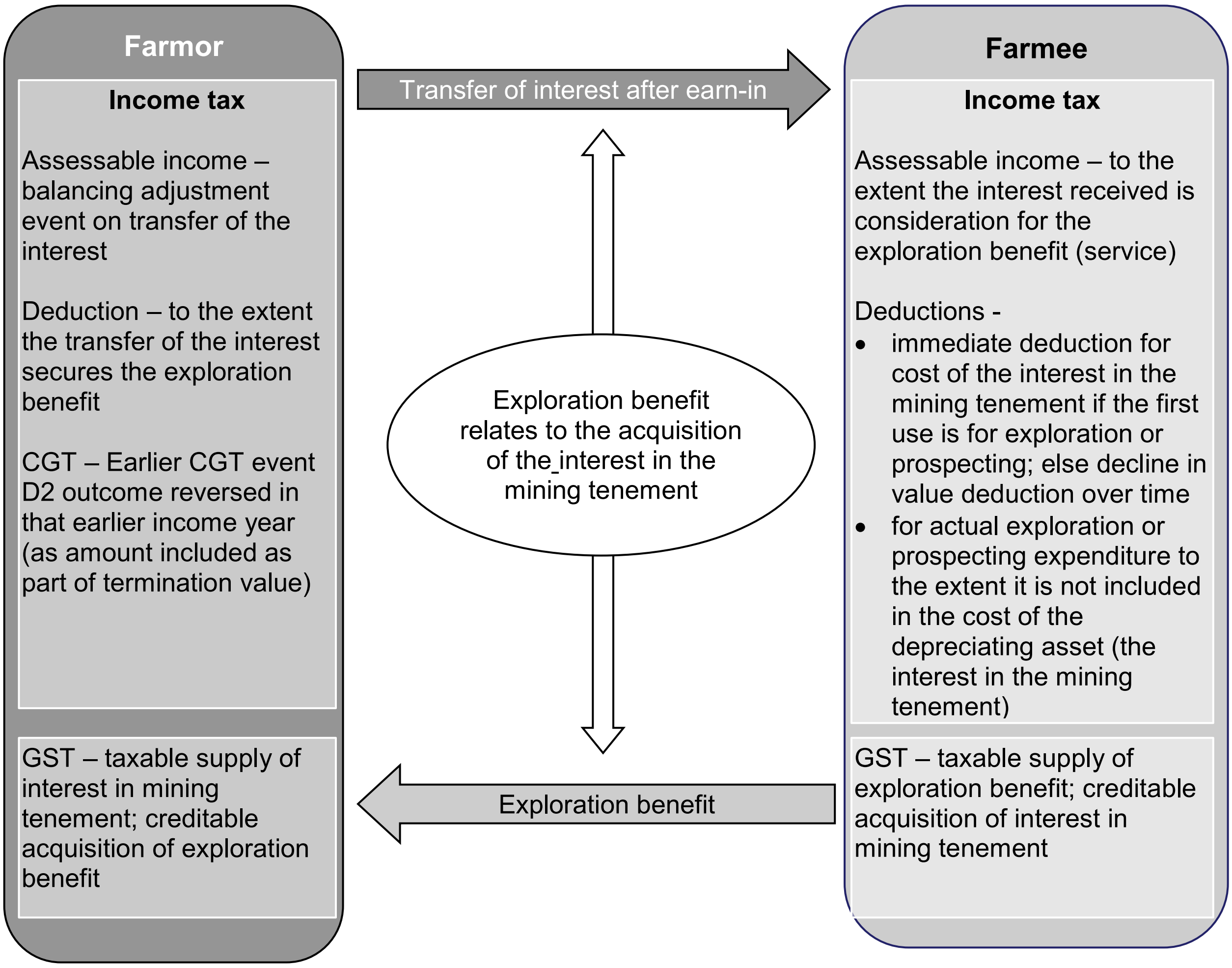
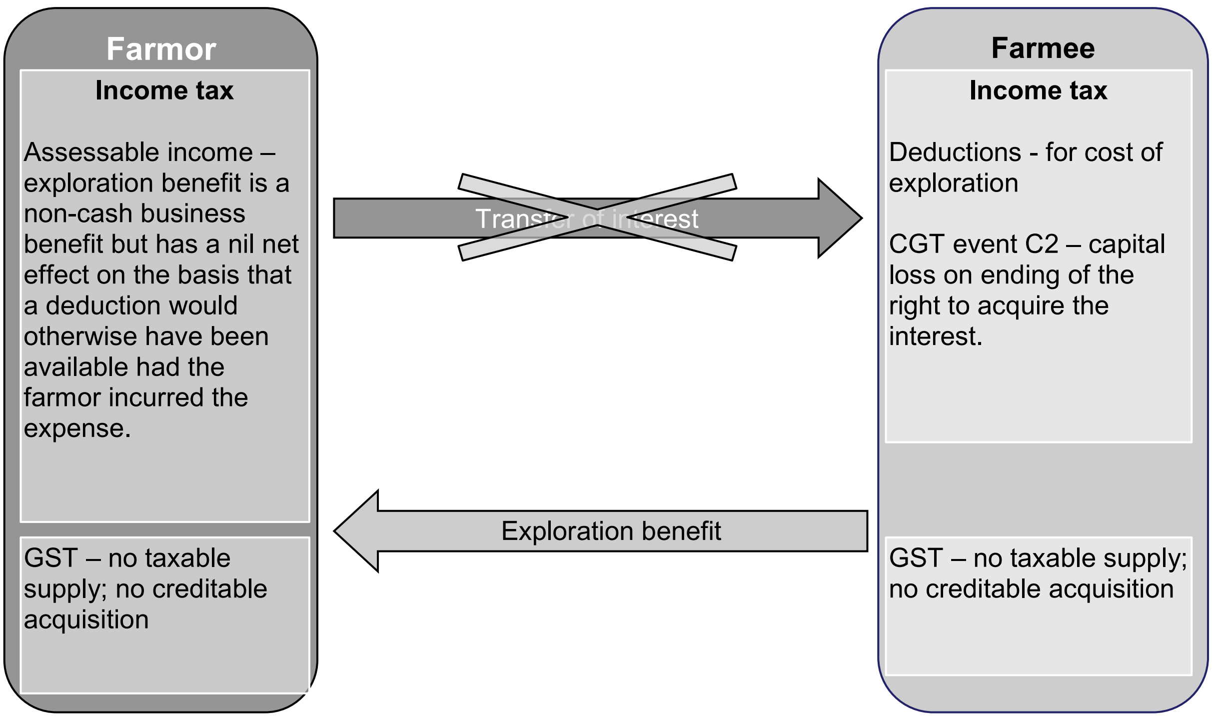


Diagram 5 – consequences if there is no transfer of the interest in the mining tenement



Part B – Approach to certain key issues

Exploration benefit

128. A farmee that undertakes exploration commitments (that is, whether the farmee does the exploration or contracts a third party to do the exploration) provides an exploration benefit to the farmor. For the UCA provisions, it is necessary to determine if that benefit is a non-cash benefit.

129. A 'non-cash benefit' is defined in subsection 995-1(1) of the ITAA 1997 as follows:

> ***non-cash benefit*** is property or services in any form except money. If a non-cash benefit is dealt with on behalf of an entity, or is provided or dealt with as an entity directs, the benefit is taken to be provided to the entity.

130. Thus for that benefit to be a non-cash benefit as defined it must be property or services. As the benefit is not property, it is necessary to consider if it is services.

131. The term 'services' is not defined in the ITAA 1997. It therefore takes on its ordinary meaning in the context in which it appears.[75]

132. Service is defined in the *Macquarie Dictionary* (Fourth Edition) as:

> 1. an act of helpful activity.
>
> 2. the supplying or supplier of any articles, commodities, activities, etc., required or demanded.

133. Whether or not in the context of the definition of non-cash benefit, the term 'service' is intended to have the first meaning, it does have the second meaning. Further, there is nothing in the context to suggest the term 'service' as used in the definition of non-cash benefit should have a narrower meaning.

134. By the farmee undertaking the exploration commitments, there is the carrying out of, and the performance of, contractual obligations by the farmee. The farmee is carrying out activities required to be undertaken to meet its contractual obligations to the farmor as the interest in the mining tenement is transferred by the farmor only if the exploration commitments are satisfied. Additionally, the farmee's exploration satisfies (at least in part if not fully) the farmor's minimum expenditure commitments as holder of the mining tenement or an interest in the mining tenement. The exploration commitments are, or are part of, the consideration that supports the existence of the contract between the parties.

135. Consequent upon the ordinary meaning of service, there is the provision of a service (an exploration benefit) by the farmee to the farmor that is a non-cash benefit.[76]

---

[75] As expressed in *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408 per Brennan CJ, Dawson, Toohey and Gummow JJ.

136. However, a reference to exploration benefit does not necessarily equate the exploration benefit with the amount to be spent by the farmee on the exploration commitments.

137. It is recognised that, as the farmee is deciding whether or not to exercise the right to acquire the interest in the mining tenement, the exploration commitments are in part for its own benefit. However, the farmor is also benefiting to some extent from those exploration commitments consistent with what it has contracted for. In a typical deferred transfer farm-out arrangement, the agreement remains on foot while the exploration commitments are being met.

Linking the exploration benefit with the transfer of the interest in the mining tenement

138. It might be argued that if the farmee is obligated to undertake a certain amount of mandatory exploration in an initial period (for example, in the first 12 months), the exploration benefit to the farmor as a result of that work is connected with, or reasonably attributable to, the things provided by the farmor to the farmee upon entering into the agreement. It might also be argued that the exploration benefit provided by the farmee to the farmor as a result of the additional (optional) exploration is also connected with the things provided by the farmor to the farmee upon entering into the agreement.

139. Although these arguments have some merit, in the context of these arrangements, there is a closer relationship between the provision of the exploration benefit by the farmee and the transfer of the interest in the mining tenement. The exploration during the initial period (if there is mandatory exploration) is part of the total exploration to be carried out during the earn-in period. The farmee decides as it goes along whether or not to continue and, ultimately, it is the total exploration with the resulting exploration benefit to the farmor that leads to the farmee being able to exercise the right to acquire the interest in the mining tenement.

140. Thus, linking the exploration benefit to the transfer of the interest in the mining tenement is more consistent with the overall purpose of these arrangements and the potential risks and rewards for each party (as discussed at paragraphs 151 and 152 of this Ruling). That is, the farmor potentially gives up part of its interest in the mining tenement to secure exploration and the farmee undertakes the exploration to have the opportunity to acquire an interest in the mining tenement.

---

[76] This is reinforced if the farmee provides information about the results of exploration to the farmor.

141. For these reasons, the exploration benefit resulting from any mandatory exploration as well as the optional exploration is most appropriately connected with, or reasonably attributable to, the transfer of the interest in the mining tenement rather than the other rights[77] under the agreement which facilitate the main purpose of the agreement.

Market valuation

142. As explained at paragraph 35 of this Ruling, if the parties are dealing with each other at arm's length, the market value of the exploration benefit provided by the farmee and any cash payments made to, or on behalf of, the farmor by the farmee is equal to the market value of the interest in the mining tenement and any other benefits that are provided by the farmor to the farmee.[78]

143. It is therefore necessary to consider market value[79] for both UCA and GST purposes.

144. Determining market value is a question of objective fact.

145. Market value is worked out on the basis of what a willing but not anxious provider of the thing would agree on with a willing but not anxious acquirer of the thing as payment for it. This may be determined by reference to a hypothetical market.

146. This is based upon the common law test for market value as developed in *Spencer v. The Commonwealth.*[80] The High Court provided a summary of this test in *Abrahams v. FC of T*[81] where Williams J said (at page 29) that market value is:

> the price which a willing but not anxious vender could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay… if the vendor and purchaser had got together and agreed on a price in friendly negotiation…

147. Relevant to the question of valuation are the facts and surrounding circumstances including the terms of the agreement and what is known about the mining tenement at the time of entering into the farm-out agreement.

---

[77] That is, the right to acquire the interest in the mining tenement and the exclusive use and access rights.

[78] This is consistent with Goods and Services Tax Ruling GSTR 2001/6: non-monetary consideration (paragraphs 19 and 138 of that Ruling).

[79] For GST purposes, it is the GST-inclusive market value of the non-monetary consideration. For UCA purposes, in determining the market value of the non-cash benefit, Subdivision 27-B of the ITAA 1997 is relevant. It is the GST-inclusive market value for UCA purposes to the extent that the relevant entity cannot claim an input tax credit. For example, if the farmee is entitled to a full input tax credit in relation to the acquisition of an interest in the mining tenement, the relevant amount for UCA purposes would be the GST-exclusive amount.

[80] (1907) 5 CLR 418.

[81] (1944) 70 CLR 23.

148. If the farm-out agreement specifies the market value of the interest in the mining tenement, then that value would be part of the evidence to be taken into account in determining the market value of the interest in the mining tenement.

149. Further, the value of an interest in a mining tenement when little is known about the mining tenement is likely to be different to its value at a later stage of exploration or development when more is known about the mining tenement.

150. For example, the price that a willing but not anxious purchaser might pay at the greenfields stage may be minimal if there has been no exploration discoveries and eventual production from that area is very uncertain.

The time for determining the market value

151. In the context of these arrangements, the relevant time for determining the market value of the interest in the mining tenement that is subsequently transferred by the farmor to the farmee is at the time of entering into the farm-out agreement. Similarly, other non-cash benefits, whether provided by the farmor or the farmee (for example, the exploration benefit), should be valued at that time. The market valuation must take into account all the facts and surrounding circumstances at that time.

152. The market value of the interest in the mining tenement at the time of entering into the farm-out agreement is considered appropriate on the basis that the farmee's service has a value at the time the arrangement is negotiated and entered into. It is, therefore, reasonable to assume that the value of the farmee's service equates to the value that the interest in the mining tenement has at that time (less any payments to, or on behalf of, the farmor for that interest) rather than at the time of the transfer of the interest to the farmee.[82] No matter what is, or is not, found by way of minerals, the farmor is committed to dispose of the interest in the mining tenement if the farmee meets the earn-in requirements and exercises the right to acquire the interest.

153. The farmee accepts risk in entering into the deferred transfer farm-out arrangement because the farmee undertakes exploration work for its own benefit – work which also benefits the farmor. The farmee may also receive benefits that might arise from an increase in the value of the interest in the mining tenement that it may acquire. Likewise, the farmor accepts risk, including the risk of having to share with the farmee the potential value in the mining tenement.

[82] This approach is consistent with Goods and Services Tax Ruling GSTR 2001/6 (paragraph 160). The UCA provisions do not suggest that a different approach is warranted in the context of a deferred transfer farm-out arrangement.

154. In summary, any potential disparity in market value between the market value of the farmee's service, and the market value of the farmor's interest in the mining tenement at the time of transfer by the farmor, could be seen as reward for risk taken by the farmee. It is for this reason that the termination value of the interest in the mining tenement disposed of by the farmor might not be said to equate with the interest's market value at the time of disposal. This is consistent with the fact that the farmor agrees to forgo the percentage interest at a time when the farmor has imperfect knowledge about the worth of the interest.

Part C – Application of the income tax law

155. This Part of the explanation considers:

- the application of the UCA provisions; and
- the application of sections 6-5, 15-2 and 15-40 of the ITAA 1997.

Application of the UCA provisions

156. A 'mining, quarrying or prospecting right' is a depreciating asset[83] and includes an interest in the relevant authority, licence, permit, right or lease.[84] The interest in the mining tenement held by the farmor is therefore a depreciating asset.

157. The UCA provisions apply in relation to the interest in the mining tenement that is transferred by the farmor to the farmee. The UCA provisions may also have application to other elements of a deferred transfer farm-out arrangement such as to determine the deductibility of certain expenditure incurred by the farmor and farmee.

Splitting of the mining tenement

158. When the farmor transfers part of its interest in the mining tenement to the farmee, the farmor's interest is split into two depreciating assets, the interest they retain and the interest they transfer to the farmee.[85]

159. The first element of cost of each of the two depreciating assets, as a result of the split, is worked out under section 40-205 of the ITAA 1997 as being a reasonable proportion of both the adjustable value of the depreciating asset that the farmor held and any other capital costs involved in splitting that depreciating asset.

---

[83] See paragraph 40-30(2)(a) of the ITAA 1997.
[84] See paragraph (c) of the definition of *mining, quarrying or prospecting right* in subsection 995-1(1) of the ITAA 1997.
[85] Section 40-115 of the ITAA 1997.

160. No balancing adjustment event occurs by reason only of the split into the two depreciating assets.[86] A balancing adjustment event does, however, occur for the interest in the mining tenement transferred by the farmor to the farmee.[87]

Exploration or prospecting expenditure deductions

161. Broadly speaking, expenditure incurred by an entity on exploration or prospecting is deductible under subsection 40-730(1) of the ITAA 1997 if the entity carried on mining operations, or proposed to carry on such operations, or is in the business of exploration or prospecting.

162. The interest in the mining tenement that the farmor transfers to the farmee is in return for exploration or prospecting and to that extent the transfer of the interest secures the exploration benefit for the farmor. For the reasons explained in Miscellaneous Taxation Ruling MT 2012/1 (paragraphs 110 to 119), the farmor has incurred 'expenditure' for the purposes of subsection 40-730(1) of the ITAA 1997.

163. The farmor is entitled to a deduction under subsection 40-730(1) of the ITAA 1997 if the expenditure is incurred on an activity that falls within the definition of 'exploration or prospecting' under subsection 40-730(4) of the ITAA 1997.

164. However, the expenditure incurred by the farmor on exploration or prospecting is only deductible under subsection 40-730(1) of the ITAA 1997 subject to subsections 40-730(2) and 40-730(3) of the ITAA 1997 not applying.

165. If subsections 40-730(2) and 40-730(3) of the ITAA 1997 do not apply, the deduction is allowed in the income year in which the expenditure is incurred. That is, the income year in which the farmee exercises the right to acquire the interest in the mining tenement. This is on the basis that the farmor has an obligation to transfer the interest in the mining tenement at that time.

166. Subsection 40-730(2) of the ITAA 1997 applies if the expenditure is on the following activities:

- development drilling for petroleum; or
- operations in the course of working a mining property, quarrying property or petroleum field.

167. Whether the interest in the mining tenement that the farmor transfers to the farmee is expended on an activity listed under subsection 40-730(2) of the ITAA 1997 necessarily depends on the particular facts and circumstances.

---

[86] Subsection 40-295(3) of the ITAA 1997.
[87] Subsection 40-295(1) of the ITAA 1997.

168. Activities for the purposes of subsection 40-730(2) of the ITAA 1997 include actual extraction activities and developmental work such as preparing a site for mining operations and providing water, light and power for use on the site for future mining operations as specified in section 40-860 of the ITAA 1997. As such, subsection 40-730(2) of the ITAA 1997 will apply to deny a deduction to a taxpayer in circumstances where the expenditure is for one of those developmental or mining operations activities rather than exploration or prospecting activities.

169. Subsection 40-730(3) of the ITAA 1997 applies if the expenditure forms part of the cost of a depreciating asset.

Application of sections 6-5, 15-2 and 15-40 of the ITAA 1997

Farmor sharing mining information for identified consideration

170. If the parties have identified any consideration provided by the farmee as being for mining information shared[88] by the farmor with the farmee on entering into the agreement, the consideration is assessable income of the farmor under section 6-5 or section 15-40 of the ITAA 1997.

171. Consideration received for dealing with or disclosing mining information is assessable as ordinary income under section 6-5 of the ITAA 1997 if the information:

- is obtained for the purpose of profit making; or
- is dealt with or disclosed under an agreement for the provision of a service that involves sharing the information with another person and has no adverse effect on the profit-yielding structure of the business.

172. Section 15-40 of the ITAA 1997 provides that a taxpayer's assessable income includes any amount[89] received for providing mining information to another entity if:

- the taxpayer continues to hold the information for UCA purposes;[90] and
- the amount is not assessable as ordinary income under section 6-5 of the ITAA 1997.

[88] That is, the farmor continues to hold that information.
[89] An amount can include the value of a non-cash benefit (see sections 21 and 21A of the ITAA 1936).
[90] See section 40-40 of the ITAA 1997.

Farmee's reward for providing the exploration benefit

173. Reward for the provision of a non-cash benefit can be assessable as ordinary income under section 6-5 or statutory income under section 15-2 of the ITAA 1997. This is so even if the provision of the non-cash benefit is an isolated transaction rather than regularly provided as part of a business or profession of providing such benefits.[91]

174. As the consideration received by the farmee (that is, the interest in the mining tenement from the farmor) is reward for the provision by the farmee of the exploration benefit, it is assessable income of the farmee under section 6-5 or 15-2 of the ITAA 1997. That is, the provision of the exploration benefit is treated in the nature of a service by the farmee on revenue account.

175. It is assessable income in the income year in which the farmee exercises the right to acquire the interest in the mining tenement.

---

[91] See *Brent v. Commissioner of Taxation* (1971) 125 CLR 418; R.W Parsons, *Income Taxation in Australia,* Law Book Company, 1985, paragraphs 2.374 and 2.375.

Appendix 2 – Detailed contents list

176. Below is a detailed contents list for this Ruling:

References

Previous draft:

MT 2011/D2

Related Rulings/Determinations:

IT 2378; GSTR 2000/29; GSTR 2001/6; GSTR 2002/5; GSTR 2004/2; MT 2012/1; PAR 2000/1

Subject references:

- balancing adjustment event
- disposal of mining & exploration rights
- disposal of petroleum mining &exploration rights
- economic rights & entitlements
- farm-out arrangements
- GST farm-in, farm-out
- GST mining & energy
- mining & exploration rights
- mining & petroleum
- mining property
- non-cash benefits
- petroleum mining & exploration rights

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 15-2
- ITAA 1997 15-40
- ITAA 1997 Subdiv 27-B
- ITAA 1997 Div 40
- ITAA 1997 40-25(1)
- ITAA 1997 40-30(2)(a)
- ITAA 1997 40-40
- ITAA 1997 40-40 item 5
- ITAA 1997 40-40 item 10
- ITAA 1997 40-60
- ITAA 1997 40-80(1)
- ITAA 1997 40-115
- ITAA 1997 40-185(1)(b)
- ITAA 1997 40-185(1)(b) item 1
- ITAA 1997 40-185(1)(b) item 4
- ITAA 1997 40-205
- ITAA 1997 40-295(1)
- ITAA 1997 40-295(3)
- ITAA 1997 40-305(1)(b)
- ITAA 1997 40-305(1)(b) item 1
- ITAA 1997 40-305(1)(b) item 4
- ITAA 1997 40-730(1)
- ITAA 1997 40-730(2)
- ITAA 1997 40-730(3)
- ITAA 1997 40-730(4)
- ITAA 1997 40-860
- ITAA 1997 Part 3-1
- ITAA 1997 102-5(1)
- ITAA 1997 104-10
- ITAA 1997 104-10(3)
- ITAA 1997 104-25
- ITAA 1997 104-35
- ITAA 1997 104-40
- ITAA 1997 104-40(5)
- ITAA 1997 116-20
- ITAA 1997 116-65
- ITAA 1997 118-20
- ITAA 1997 118-24(1)
- ITAA 1997 118-24(2)
- ITAA 1997 134-1(1) item 1
- ITAA 1997 995-1(1)
- ITAA 1936 21
- ITAA 1936 21A
- ITAA 1936 21A(1)
- ITAA 1936 21A(2)
- ITAA 1936 21A(3)
- ITAA 1936 21A(5)
- GSTA 1999 9-5
  GSTA 1999 9-17(1)
- GSTA 1999 9-17(1)(a)
- GSTA 1999 11-5
- GSTA 1999 Div 29
- GSTA 1999 29-5(1)(a)
- GSTA 1999 29-5(1)(b)
- GSTA 1999 29-5(2)
- GSTA 1999 29-5(2)(a)
- GSTA 1999 29-10(1)(a)
- GSTA 1999 29-10(1)(b)
- GSTA 1999 29-10(2)
- GSTA 1999 29-10(2)(a)
- GSTA 1999 29-10(3)
- GSTA 1999 29-25
- GSTA 1999 38-325
- GSTA 1999 Ch 4
- GSTA 1999 Div 93

Case references:

- Abrahams v. FC of T (1944) 70 CLR 23, [1944] HCA 32
- Brent v. Commissioner of Taxation (1971) 125 CLR 418, 2 ATR 563; 71 ATC 4195; [1971] HCA 48
- CIC Insurance Ltd v. Bankstown Football Club Ltd (1997) 187 CLR 384, [1997] HCA 2

- Spencer v. The Commonwealth (1907) 5 CLR 418, [1907] HCA 82

Other references:

- A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000 (F2006B11593)
  A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2012 (F2012L00866)
- Birch, C., 'Choosing the Right Joint Venture Structure for a Farmin or Farmout' [2002] JIATax 3; (2002) 5 (1) Journal of Australian Taxation 60
- Macquarie Dictionary
- Mineral Resources Act 1989 (Qld)
- Mining and Metals Refining IFRS, May 2009, available at www.ey.com.au
- Parsons, R.W. Income Taxation in Australia, LBC, 1985
- Tax and Superannuation Laws Amendment (2014 Measures No. 3) Act 2014
- Tax and Superannuation Laws Amendment (2015 Measures No. 2) Act 2015

ATO references

NO:	1-2YN0REK
ISSN:	1443-5160
ATOlaw topic:	Income Tax ~~ Industry specific matters ~~ mining and energy