TR 2014/9EC - Compendium

Ruling Compendium – TR 2014/9

This is a compendium of responses to the issues raised by external parties to Draft Taxation Ruling TR 2013/D4 *Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?*

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

Note: a number of items in the 'Issue raised' column comment on the concept of exploration in the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Income Tax Assessment Act 1997* (ITAA 1997). Comparisons are also made between the treatment of exploration in the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA)[1] and in the ITAA 1936 and ITAA 1997. The ATO responses in the table do not comment on the correctness or otherwise of statements made about exploration in the ITAA 1936 or ITAA 1997 as this is outside the scope of this Ruling. They have been referred to the ATO team reviewing Taxation Ruling TR 98/23 *Income tax: mining exploration and prospecting*.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	**The final Ruling should include an 'Alternative views' section** The inclusion of this section is important given the difference of opinion that exists on how the provisions operate and the significant commentary that has been provided during the consultation process. It is also likely to be important for some taxpayers from an accounting, legal and business perspective. For example, the Alternative views section would support the positions which may have been adopted by taxpayers for accounting purposes, under contracts and in internal management reports, etcetera. It is important however that the Alternative views section should be broader than just the 'Compendium of views' published by the ATO. The Compendium does not set out the detailed reasons for the Alternative views, but instead is simply a 'rebuttal' by reference to issues, without the underlying arguments being fully expressed and	There has been an extensive consultation process in developing the Ruling. The Commissioner has considered all of the issues and views raised with regard to TR 2013/D4 (the draft Ruling) and distilled them into a number of key points which are covered in the Alternative views section of the Ruling. In addition, the Commissioner has sought to present and comment on all of the issues and views raised by respondents in this Compendium.

[1] All legislative references in this Compendium are to the PRRTAA unless otherwise indicated.

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	analysed. Detailed comments on the alternative positions have been provided during previous consultations. This should be further expanded to cover additional comments provided during this phase of the process.	
2	**Ordinary meaning of exploration** To focus on the 'ordinary meaning' of the word exploration in isolation provides limited guidance. The focus should be on the meaning of particular phrases such as 'exploration for petroleum' and 'exploration expenditure incurred by a person…in relation to the project'. This properly brings into focus 'for what' and also the 'why' of the exploration and in turn the scope of the activities to be covered by the relevant exploration provision.	The Ruling considers the meaning of the phrase 'exploration for petroleum' and 'involved in or in connection with exploration for petroleum' in its legislative context. The 'ordinary meaning' of exploration is covered as part of this. The Ruling is consistent with the views expressed by the Administrative Appeals Tribunal (the Tribunal) in *ZZGN and Commissioner of Taxation* [2013] AATA 351 (*ZZGN*), where the Tribunal considered the meaning of exploration in its statutory context, in the light of the legislative history of the PRRTAA and by referring to relevant case law and extrinsic materials (see *ZZGN* at 312, 322 and 390).
3	**History of Exploration for Minerals** There is nothing in the origins of the definition of 'exploration for…' used in the ITAA 1936 that points to exploration for minerals being limited to the discovery of a geographical commercial quantity of resource. In fact all activity up to the point where a mining company commences to prepare the site for mining could be seen as exploration and a normal business expense. A similar conclusion can be reached for exploration in this context, given the historical context and legislative linkages the exploration provisions in PRRTAA have to the income tax rules.	The Commissioner does not consider the treatment of exploration expenditure for income tax purposes governs the interpretation of section 37 of the PRRTAA and notes that the PRRTAA and the *Income Tax Assessment Act 1997* (ITAA 1997) deal with exploration expenditure in different ways (see paragraph 13 of the Ruling). This proposition is supported by *ZZGN* as the Tribunal considered the relevance of the income tax treatment of exploration expenditure and concluded the construction of section 37 of the PRRTA must be discerned from the terms of that Act alone (along with relevant extrinsic materials) (see *ZZGN* at 250, 312, and 378).

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		Also see Issue 7 of the Compendium of Views published with the draft Ruling on 21 August 2013.
4	**Meaning of exploration for Petroleum Resource Rent Tax (PRRT) purposes** **Interpretation will lead to unintended black hole expenditure** The Commissioner's view could result in 'Black hole' expenditure in terms of non-transferrable expenditure where a production licence never comes into force in relation to an exploration permit or retention lease, and through the possibility of expenditures falling outside the scope of sections 37, 38 and 39 (and not being the type of excluded expenditure as envisaged under section 44). These outcomes are inconsistent with Parliament's intention to encourage exploration. There is no material to support the contention that Parliament intended for either of the above situations to arise. For instance, the reference in paragraph 38(1)(a) to 'providing operations and facilities preparatory to the activities referred to in paragraph (b), including in carrying out any feasibility or environmental study', is limited to a feasibility study that is general project expenditure, but not exploration expenditure. In our view, the reference to feasibility studies in this context was not intended to capture all feasibility studies. Hence, the exclusion of exploration expenditure in subsection 38(1). Activities preparatory to carrying on or providing the operations, facilities and other things comprising a project does not include activities directed at making a decision to mine, which are exploration. Accordingly, if feasibility studies undertaken prior to a decision to mine, for the purposes of making such a decision, are not exploration for the purposes of section 37, then a significant black-hole would	The Commissioner does not consider his view will create a significant black-hole that was not identified or not intended by Parliament. In the Commissioner's view, payments that do not satisfy the requirements for exploration expenditure in section 37, will be deductible where they satisfy the requirements in section 38 (see paragraphs 9, 10 and 116 of the Ruling). For example, feasibility studies will in many cases fall within the scope of paragraph 38(1)(a) rather than section 37 as they are often directed at determining the viability of developing a resource and making a decision to mine. Where the requirements in paragraph 38(1)(a) are satisfied the expenditure can be deductible as general project expenditure once there is a petroleum project in relation to a production licence (that is in force) (see paragraphs 116 to 124 of the Ruling). The Commissioner considers the overall design of the PRRTAA as a project based resource profits tax, contemplates that there may be situations where expenditure incurred in relation to a project or a potential project, may not be utilised if the project does not proceed (see paragraph 139 of the Ruling). This issue is considered in paragraphs 137 to 139 of the Alternative views section of the Ruling. Also see Issue 4 of the Compendium of Views published with the draft Ruling on 21 August 2013.

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	emerge as it may also not constitute general project expenditure as it may fall outside the scope of paragraph 38(1)(a). Section 38 was intended to capture feasibility studies of a nature not captured by section 37 such as feasibility studies in relation to project expansion and debottlenecking.	
5	**The view expressed in the Ruling as to the meaning of exploration is too narrow and does not take into account its legislative context** The meaning of exploration in the Ruling is too narrow as it does not take into account: (a) the need to interpret words in their context (b) the context of an undefined word in the Act must have regard to the intention of the Act to operate within the petroleum industry (c) the fact that the concept of exploration had a generally understood meaning both in industry and in taxation law at the time the legislation was introduced and in that sense may be argued to have had a technical meaning which differs from the ordinary meaning.	In the Commissioner's view, the words 'exploration for petroleum' bear their ordinary meaning, as understood in the context in which they appear in the PRRTAA, and there is no indication that it was intended that a technical or trade meaning was preferred over the ordinary meaning (see paragraphs 3 to 5 and 79 to 82 of the Ruling). The considered views of the Tribunal in *ZZGN* support this proposition. The Tribunal concluded there is nothing to suggest that the term 'exploration' should be read as meaning anything other than its ordinary meaning in the context in which it appears in the PRRTAA. The Tribunal took the view that the evidence did not justify any contention that the word 'exploration' is to be read in the context of the PRRTAA as a term of art or as having a particular technical meaning (see *ZZGN* at 312 to 314). Also see Issue 1 of the Compendium of Views published with the draft Ruling on 21 August 2013.
6	**The ordinary meaning of exploration is broader than the Commissioner contends in the Ruling** Even in its ordinary and common usage, the concept of exploration is broader than the concept of prospecting which encompasses the search or exploration of a region, or working of a claim experimentally	The Commissioner considers the ordinary meaning of exploration is the relevant concept and that it is limited to the discovery and identification of the existence, extent and nature of petroleum (see paragraphs 3 to 5 and 83 of the Ruling).

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	in order to test its value. As the word exploration suggests, the ordinary meaning also covers activities which are exploratory in nature including investigation, scrutiny and examination. For example, the Oxford English Dictionary defines 'exploration' as: The action of examining; investigation, scrutiny, Obs. 2. The action of exploring (a country, district, place, etc); an instance of this. Also transf 'Explore' is defined as 1.a. To investigate, seek to ascertain or find out (a fact, the condition of anything). b. To search for; to find by searching; to search out. Obs 2.a. To look into closely, examine into, scrutinize; to pry into (either a material or immaterial object). In later use coloured by association with 3.b. To examine by touch; to probe (a wound). 3.a. esp. To search into or examine (a country, a place, etc) by going through it; to go into or range over for the purpose of discovery. Fig. phr. To explore every avenue (or to explore avenues), to investigate every possibility. b. intr. To conduct operations in search for. c. To make an excursion; to go on an exploration (to).	In the Commissioner's opinion the considered views of the Tribunal in *ZZGN* support this proposition (see *ZZGN* at 322).
7	**Exploration is part of a larger process** Exploration is not undertaken in a vacuum to merely identify the presence of a resource, but is undertaken with a particular objective in mind, namely to identify, locate and understand a resource which is capable of economic exploitation and in the context of the PRRTAA, capable of development into a project. This context suggests that the investigation, scrutiny and the examination is not merely one directed towards finding a resource and whether it is technically feasible to extract it, but is directed towards the investigation, scrutiny and examination necessary to find and understand a resource which is capable of development into a petroleum project that will produce a marketable petroleum	The Commissioner considers the ordinary meaning of 'exploration' taken in the context of section 37 does not extend to the scrutiny and examination of a discovery for future development (see paragraphs 8 and 113 to 115 of the Ruling). The ordinary meaning also does not include whether it is technically feasible to extract a resource. In the Commissioner's opinion the considered views of the Tribunal in *ZZGN* support this proposition (see *ZZGN* at 322).

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	commodity.	
8	**Exploration had acquired a particular legal meaning before the introduction of the PRRT and this legal meaning must be considered** Prior to the introduction of the PRRTAA, exploration may be argued to have acquired a particular legal meaning. The concept had been referred to in a number of taxation cases and was used by the Commissioner, taxpayers and government to refer to particular types of activities when dealing with taxation legislation. Therefore, at the very least, the PRRTAA was introduced in a context in which both the ATO and taxpayers had an understanding that exploration extended to various feasibility studies.	The Commissioner does not agree that the meaning of exploration had a particular legal meaning when the PRRTAA was introduced that should be adopted for PRRT purposes. In the Commissioner's opinion, references to the meaning of exploration in other contexts such as income tax do not govern the interpretation of section 37 (see paragraph 13 of the Ruling). The considered views of the Tribunal in *ZZGN* support the Commissioner's view (see *ZZGN* at 248 to 250).
9	**Exploration involves activities that are relevant to the decision to mine which is recognized by the phased approach** Exploration is a means by which a taxpayer achieves its objective. The relevant objective goes beyond prospecting and includes investigating, evaluating and scrutinizing information that is relevant to the decision to mine. This decision making process is part of a continuum that is recognized by the phase approach. To ignore the phase approach is to ignore the context in which the Act was drafted and intended to operate, thereby frustrating the intent and purpose of the Act. There is nothing to suggest that the meaning of exploration for the purposes of the PRRTAA should not be based on a phased approach to defining exploration. That is, activities in relation to the discovery and determination of a commercially recoverable accumulation of petroleum which supports a decision to mine are exploration and	The PRRTAA does not use the concept of a phase approach or decision to mine and the Commissioner does not consider these concepts are determinative in establishing the character of the expenditure incurred (see paragraphs 14 and 128 of the Ruling). The Tribunal in *ZZGN* considered this issue in reaching its decision and concluded that the distinction between the 'exploration phase' and 'production phase' was not a relevant distinction for the purposes of the PRRTAA (see *ZZGN* at 319). The Tribunal also held it would run counter to the wording, context and purpose of the PRRTAA if section 37 was read in such a way that all project expenditure incurred by a person up to the final investment decision of the project was within the scope of the provision (see *ZZGN* at 387 and 389).

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	activities in relation to the development and recovery of petroleum involve general project expenditure.	See also response at Issue 1 of the Compendium of Views published with the draft Ruling on 21 August 2013.
10	**Commissioner's view will create a significant new and unexplained structural feature in the PRRTAA** The ordinary meaning of exploration should not be defined in a manner that creates a significant new and unexplained structural feature (unintended black holes) in the PRRTAA. This approach to the interpretation of undefined terms has been specifically highlighted by the Federal Court in relation to the PRRTAA. For example, refer to the following extracts in *Esso Australia Resources Pty Ltd v. The Commissioner of Taxation* [2011] FCA 360 at [225 & 226], in relation to the interpretation of the PRRTAA: > Nothing is more likely to defeat the intention of the legislature than to give a definition a narrow, literal meaning and then use that meaning to negate the evident policy or purpose of a substantive enactment. … > While words may have a stand-alone meaning or meanings which may be found in a dictionary, generally oral or verbal communication does not proceed by way of individual words but by language; by words used in conjunction with one another to express propositions or sentiments or otherwise communicate meaning. The task of a court in construing a statute is to construe the language of the statute, not the individual word.	In the Commissioner's view, the words 'exploration for petroleum' bear their ordinary meaning, as understood in the context in which they appear in the PRRTAA, and there is no indication that it was intended that a technical or trade meaning was preferred over the ordinary meaning (see paragraphs 3 to 5 and 79 to 82 of the Ruling). The Commissioner considers the *ZZGN* decision supports this proposition (see *ZZGN* at 312 to 314). See also response at Issue 4 of this Compendium.
11	**The decision to mine (and the things needed to occur in order to make such a decision) and the phased approach are pivotal in establishing expenditure that is exploration and expenditure that is development** There are several sources that support the position that, for taxation purposes (including PRRT), a decision to mine is a pivotal point	Section 37 of the PRRTAA does not use the concept of a phase approach or decision to mine and the Commissioner considers that these concepts are not determinative in establishing the character of expenditure incurred (see paragraphs 14 and 128 of the Ruling). The Commissioner considers the *ZZGN* case supports this

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	between that which is exploration and that which is development which was available to inform Parliament of the intended meaning of exploration for purposes of the Act at the time of its enactment. In *Mount Isa Mines Ltd v. Federal Commissioner of Taxation* (1992) 92 CLR 483 (*MIM*) the High Court considered whether certain expenditure incurred because the taxpayer regarded it as necessarily involved in the establishment and maintenance of its mining undertaking was incurred on the development of a mining property. In his decision Taylor J stated at [488]: > The work upon which the bulk of the expenditure in question was incurred took place during three different phases of the appellant's activities. The first was the work of prospecting and exploration which, of necessity, preceded, in part at least, the decision to establish a mining undertaking in the area. The results of this work no doubt led to the decision to exploit the mineral resources of the area and that decision was succeeded by a period in which the work of assembling the necessary plant and the other preparatory work essential to the commercial operation of the undertaking took place. Possibly the work of prospecting continued into this period, though whether it did or not does not clearly appear. The third phase commenced in 1931 since when the appellant has been engaged in working the mining property for profit (emphasis added) Then at [491]: > (I)t is reasonably clear that, in general, prospecting and exploration work precedes the work of 'development' however broadly that term may have been used in s 122. As a rule the former work is undertaken to ascertain, as far as possible, whether the commencement of mining operations would be justified or prudent. (emphasis added) In *MIM,* Taylor J also referred (at p 491) to work broadly answering the description of prospecting, in one sense, that may be carried on upon an established mining property for the purpose of determining the best	conclusion (see *ZZGN* at 319 and 389). Further, the Commissioner does not consider that statements made in an income tax context in *MIM* or the Asprey Report govern the interpretation of section 37 of the PRRTAA. See also: • response at Issue 12 of this Compendium. • Issues 1 and 10 of the Compendium of Views published with the draft Ruling on 21 August 2013.

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	means to be adopted to facilitate the winning of minerals, the existence of which is already known as to be regarded as expenditure on development. In Industry's view, such treatment would require a decision to mine to have been made, that is, the work is upon an established mining property, and does not refer to feasibility work aimed at establishing the commercial recoverability of petroleum in respect of which no decision to mine has been made. The phase approach in *MIM* is entirely consistent with the Asprey Report which, as the Commissioner states in paragraph 98, recognised that there are distinct phases in mining operations, and those phases are treated differently in the tax legislation. 'The former (prospecting and exploration) embraces those costs incurred in searching for minerals and, upon discovery ascertaining the value and extent of a deposit.' (emphasis added)	
12	**The meaning of exploration for PRRT purposes should reflect the meaning of exploration for income tax purposes** The phase approach to mining operations suggested by Taylor J in *MIM* and in the Asprey Report is also consistent with the view of exploration set out by the Commissioner in TR 98/23 (at for example paragraph 57) (including its predecessor IT 2642) and the Explanatory Memorandum to A New Business Tax System (Capital Allowances) Bill 2001 (the Explanatory Memorandum) which stated (at paragraph 7.10) that exploration or prospecting: > is defined to include a number of things that commonly are undertaken in performing activities, such as geological mapping, geophysical surveys, exploratory drilling, studies to evaluate the economic feasibility of mining or quarrying and so on. It does not, however, include expenditure on developing or operating a mining or quarrying field or site. The point at which a decision to proceed to actual mining	The Commissioner does not consider that the treatment of exploration expenditure for income tax purposes governs the interpretation of section 37 of the PRRTAA and notes that the PRRTAA and the ITAA 1997 deal with exploration in different ways (see paragraph 13 of the Ruling). The Commissioner considers that the *ZZGN* case supports this proposition (see *ZZGN* at 250, 315, and 378). See also Issue 7 of the Compendium of Views published with the draft Ruling on 21 August 2013.

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	operations has been made, is the dividing line between exploration and prospecting on the one hand, and development and operation on the other. The Explanatory Memorandum also states (at paragraph 7.24) that the definition of exploration or prospecting is intended to reflect the definition contained in the repealed Division 330 of the ITAA 1997. Notwithstanding that Division 330 specifically included a new reference to feasibility studies, the Explanatory Memorandum clearly states that the inclusion of 'studies to evaluate the economic feasibility of mining' is a reference to 'things that commonly are undertaken in performing [exploration or prospecting] activities', and so should form part of the ordinary meaning rather than a statutory inclusion. This is consistent with the Explanatory Memorandum introducing Division 330 in 1996 which, despite describing the reference to certain feasibility studies as exploration or prospecting as 'a change', noted that the inclusion of certain feasibility studies was to reflect the Commissioner's practice to treat such studies as exploration or prospecting. Accordingly at the time the PRRTAA was enacted, Parliament was familiar with the treatment by the Commissioner of feasibility studies as exploration for tax purposes and that exploration and prospecting continued until a decision to mine is made, based on judicial statements, such as from the *MIM* decision, and the Asprey Report and which Parliament subsequently repeated in 1996 and 2001 upon enacting Division 330 and Division 40, respectively, of the ITAA 1997.	
13	**The views of independent parties as to the meaning of exploration in the context of the resources industry are relevant for PRRT purposes** The idea that the concept of 'exploration' encapsulates feasibility	In the Commissioner's view 'involved in or in connection with exploration for petroleum' in the context of section 37 does not extend to the scrutiny and examination of a petroleum field for future development. For example, this phrase does

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	studies is further supported by a number of industry publications which demonstrate that the term 'exploration' refers to a range of activities which include feasibility studies. For example in ABARE Research Report 96.4 where the exploration phase for an oil and gas project is defined in the following terms: > In prospective areas, new field wildcat wells are drilled to discover the location of accumulation. In the event of a discovery, appraisal wells may also be drilled to provide a more accurate indication of the potential size and quality of the oil and gas resources. If a discovery is significant, a feasibility study of the field for future development and production is taken. Likewise in the hardrock context the exploration process is described as one 'to locate and define a particular economically mineable mineral commodity (ore) in a mineral province' (see *Geological Methods in Mineral Exploration and Mining* at page 1) and described to include a feasibility stage which is described in the following terms: > This, the final stage in the process, is a desk-top study that assesses all factors – geological, mining, environmental, political, economic – relevant to the decision to mine. With very large projects, the costs involved in the evaluation are such that a preliminary feasibility study is often carried out during the preceding resource evaluation stage. The preliminary feasibility study will identify whether the costs involved in exploration are appropriate to the returns that can be expected, as well as identify the nature of the data that must be acquired in order to bring the project to the final feasibility stage. The resource evaluation stage referred to in this quote is the stage prior to the 'feasibility study'. The inclusion of feasibility studies as exploration is also supported by how the Australian Bureau of Statistics (ABS) collects and reports data on mineral and petroleum exploration activity in Australia. For example, the ABS relies on a broad definition of 'exploration	not cover considering whether it is economically feasible to develop or how best to develop a discovery (see paragraphs 8 and 113 to 119 of the Ruling). The Tribunal in *ZZGN* noted, that although the ABARE report described feasibility studies as falling in the 'exploration phase', that kind of activity is of a distinctly different nature to that included within the ordinary meaning of the word 'exploration'. It concluded that the ordinary meaning of the word 'exploration' did not extend to include feasibility studies of the field for future development and production (see *ZZGN* at 321 and 322).

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	expenditure' which includes the evaluation stage and feasibility studies: Exploration expenditure: Covers all expenditure (capitalised and non-capitalised) during the exploratory or evaluation stages in Australia, Australian waters, and the JPDA. Costs include cost of exploration, determination of recoverable reserves, engineering and economic feasibility studies, procurement of finance, gaining access to reserves, construction of pilot plants and all technical and administrative overheads directly associated with these functions. (emphasis added) The ABS also adopts a phase approach to the definitions of 'exploration' and 'development': Exploration: Activity involves searching for concentrations of naturally occurring solid, liquid or gaseous materials and includes new field wildcat and stratigraphical and extension/appraisal wells and mineral appraisals intended to delineate or greatly extend the limits of known deposits by geological, geophysical, geochemical, drilling or other methods. This includes drilling of boreholes, construction of shafts and adits primarily for exploration purposes but excludes activity of a developmental or production nature. Exploration for water is excluded. (emphasis added) Development: Phase usually following exploration where a prospective discovery (e.g. proven oil or gas field or concentrate of ore) is brought into production or for extending the life of a current mine or well. Activities may include preparing the ground by the removal of overburden, constructing shafts, drives and winzes; or by drilling and completing wells. All activities are for the purposes of commencing extraction/mining or extending production. (emphasis added)	
14	**The decision to mine is a dividing line between exploration and development**	The Commissioner does not consider that the decision to mine is a dividing line between exploration and development

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	The notion that the dividing line between exploration and development is the decision to mine was recently confirmed in the income tax context by Siopis J in *Mitsui & Co (Australia) Ltd v. Commissioner of Taxation* [2011] FCA 1423. This case concerned whether, a production licence under the PSLA (or part thereof) acquired by the taxpayer was first used in exploration. His Honour, after referring to the Explanatory Memorandum stated in paragraph 140: > A production licence under the PSLA is obtained for the very purpose of proceeding 'to actual mining operations'; that is, after the applicant, therefore, as the holder of an exploration licence, has carried out sufficient exploration to make a decision to exploit an identified petroleum field. It follows, therefore, that, based on the distinction referred to in the Explanatory Memorandum, Parliament contemplated that expenditure incurred on acquiring a production licence, would fall on the wrong side of 'the dividing line'. The necessary inference from this statement is that expenditure incurred prior to the granting of a production licence for the purpose of determining whether to make a decision to exploit a petroleum field is on the right side of the 'dividing line' provided that it was directed towards informing a final investment decision and not another purpose. In other words, such expenditure is exploration expenditure – both under the extended definition in the ITAA 1997 and the ordinary meaning that applies for PRRT.	in the context of the PRRTAA. See also responses at Issues 9 and 11 of this Compendium.
15	**Exploration is not intended to be limited to the discovery of minerals** Exploration is not intended to be limited to the discovery of minerals. That is far too preliminary a phase in the discovery – production cycle to be intended as the limit of the meaning of exploration. But there is no reason to draw an artificial line at physical appraisal, wherever that	The Commissioner considers the meaning of 'exploration' taken in the context of section 37 does not extend to feasibility studies of a petroleum field for future development and production (see paragraphs 8 and 113 to 115 of the Ruling). The Commissioner considers the *ZZGN* decision supports

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	line is. As noted above, the Asprey Report referred to ascertaining the 'value and extent of a deposit'. The Commissioner is of the opinion that exploration determines whether a commercial quantity of a particular resource exists. Conducting feasibility studies to ascertain the value of a discovered resource is intrinsically linked to exploration as it informs whether or not it is prudent and viable to make a decision to proceed with development. An inquiry into the value of a resource will require consideration of costs and risks associated with extraction, development, transportation and marketing. It is submitted, feasibility studies and other aspects of a decision to mine are required to be undertaken to determine the value and extent of a deposit, or the commercial quantity of a particular resource that exists, and so are to be treated as exploration for PRRT purposes.	this proposition (see *ZZGN* at 322). See also responses for Issues 3 and 7 in this Compendium. The Commissioner notes the reference in this issue to him being 'of the opinion that exploration determines whether a commercial quantity of a particular resource exists'. It is unclear what the source for this comment is, but it appears that it may be based on statements contained in TR 2010/D4[2]. TR 2014/9 now reflects the Commissioner's view of 'exploration' in the PRRTAA and is consistent with *ZZGN*.
16	**Determination of a commercial discovery in the context of the resources industry is relevant which is represented by reserves, as recognised under the Society of Petroleum Engineers-Petroleum Resource Management System. (SPE-PRMS)** In a petroleum industry context, it is widely understood and accepted that a 'commercial discovery' is represented by reserves, as recognised under the *Guidelines for Application of the Petroleum Resources Management System* (PRMS) Sponsored by: Society of Petroleum Engineers, American Association of Petroleum Geologists, World Petroleum Council, Society of Petroleum Evaluation Engineers	The Commissioner accepts the proposition that the SPE-PRMS Guidelines provide a guide to the concept of 'commercial discovery' as used in the resource industry, including the determination of the commercial viability of a discovery. However, he does not consider that these concepts are relevant to the meaning of the phrase 'involved in or in connection with exploration for petroleum' in paragraph 37(1)(a). In the Commissioner's view, the meaning of this phrase is to be determined by consideration of the context, purpose and legislative history, rather than by reference to external

[2] Draft Taxation Ruling TR 2010/D4 *Petroleum resource rent tax: general pre-conditions common to deductibility of expenditure of a kind referred to in sections 37, 38 and 39 of the Petroleum Resource Rent Tax Assessment Act 1987* which was withdrawn on 5 October 2012

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	and Society of Exploration Geophysicists. The Guidelines require feasibility studies to be undertaken to support the cash flows with the certainty required to determine whether reserves can be recognised. As a matter of principle, it is not considered that the scale of activity is relevant to its classification. In the industry's view, there is only one concept, being that of determining the extent of a commercial discovery. The investigation of different development scenarios goes to, and should be seen as, determining the extent of a commercial discovery, rather than increasing the return from a fixed reserves base. A cost of development will define whether or not there is a commercial discovery associated with the petroleum in place. This is the concept behind reserves reporting. Unless a resource can be commercially recovered there is no commercial discovery. Commercial viability determines the extent of a commercial discovery. Feasibility studies define the extent of a commercial discovery. The extent of a commercially recoverable discovery can only be determined by undertaking feasibility studies of the type under consideration. This is consistent with the PRMS Guidelines. For example, no reserves are recognised until a final investment decision ('FID') is made in respect of an LNG project because the commerciality of gas in place cannot be determined without consideration of the downstream economics. In the absence of a positive FID there is no commercial discovery. The industry's usage of determining the extent of a commercial quantity is set out in the reserves guidelines. The identification of the extent of petroleum in place and its geological/geophysical characteristics does not complete the assessment of the commercially recoverable petroleum (reserves). The extent of a commercially recoverable discovery can only be determined by undertaking	guidelines or other regulatory requirements (see paragraphs 15 and 128 of the Ruling). The Commissioner considers that the words 'exploration for petroleum' bear their ordinary meaning, as understood in the context in which they appear in the PRRTAA (see paragraphs 3 to 5 and 79 to 81 of the Ruling). Further, the Commissioner's view is that assessing the commercial viability of a discovery is not 'involved in or in connection with exploration for petroleum' (see paragraphs 8 and 113 to 115 of the Ruling). In the Commissioner's opinion, the considered views expressed by the Tribunal in *ZZGN* support these conclusions (see *ZZGN* at 315, 319, 321 & 322). Also see Issue 9 of the Compendium of Views published with the draft Ruling on 21 August 2013. Given the nature of the Commissioner's response, it has not been necessary to consider whether a field development plan is carried out **under** an exploration permit, or whether it is an activity that may occur at a time when such a permit is held.

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	feasibility studies of the type under consideration. It has been argued that work programs submitted by a licence holder for an exploration permit informs an understanding of what represents exploration, however this overlooks the nature of activities carried out under an exploration permit in respect of field development plans. Whereas the work program commitment is directed at activity which will result in the discovery of petroleum, the holder of an exploration permit which has discovered a petroleum pool is required during the tenure of the exploration permit to undertake significant appraisal work in order to establish the extent of commercially recoverable petroleum (that is reserves). Indeed, the work program merely reflects the 'minimum' requirements associated with the awarding of a permit. The holder of an exploration permit is required to prepare a field development plan in accordance with section 4.07 of the *Offshore Petroleum and Greenhouse Gas Storage (Resource Management and Administration) Regulations 2011*. This work includes feasibility studies which are required to establish the extent of petroleum which is commercially recoverable. (See in particular item 4.07(1)(c), to 4.07(1)(f).)	
17	**Decision in the *ZZGN* case should be confined to its own fact situation and should not form the basis for the general interpretation of the word exploration** The ATO position is very heavily based on the views contained in one decision of the AAT in *ZZGN* that has a particular fact pattern and where the scope of those facts do not necessarily capture the wider range of activities and factors that are prevalent across the entire industry.	The Commissioner does not agree to the proposition that the decision in *ZZGN* is not an appropriate precedent because it has a particular fact pattern that does not capture the wider range of activities and factors that are prevalent across the petroleum industry. In the Commissioner's opinion, the Tribunal reached their view on the meaning of exploration by considering the proper construction of section 37, as discerned from the terms of the Act and relevant extrinsic materials, before applying these

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		views to the particular facts before them. For example, the considered views of the Tribunal on the meaning of exploration are not dependent on the particular facts of that case (see *ZZGN* at 322). This issue is considered in paragraphs 135 and 136 of the Alternative views section of the Ruling.
18	**PRRT only applies to taxpayers in a particular industry** PRRT only applies to taxpayers in a particular industry where the technical term 'exploration' (and therefore arguably the ordinary meaning) carries a different meaning to the dictionary definition of the word and to what an ordinary person may consider to be 'exploration'.	The Commissioner considers there is no indication in the PRRTAA or in relevant extrinsic materials that suggest the term 'exploration' carries a meaning other than its ordinary meaning. Nor does the PRRTAA provide any basis for preferring a trade usage of 'exploration' over the ordinary meaning of the term (see paragraphs 3 and 79 to 82 of the Ruling). In the Commissioner's opinion, the considered views of the Tribunal in *ZZGN* support these conclusions (see *ZZGN* at 312 to 322).
19	**Issues raised in response to the discussion paper: Petroleum Resource Rent Tax – Consultation on date of effect for taxation ruling on the meaning of 'exploration' and related matters, dated 21 August 2013** The following is a summary of issues raised in response to the discussion paper on date of effect that issued with TR 2013/D4. **The Ruling should have prospective application** The Ruling should not apply to payments made before the release of the draft Ruling whether or not the expenditure had been applied to	The Ruling will apply to expenditure incurred from the date of issue of Draft Taxation Ruling TR 2013/D4 (TR 2013/D4), which was 21 August 2013. Prior to the issue of TR 2013/D4, the Commissioner had an approach, contrary to the views contained in this Ruling (and TR 2013/D4), of accepting that a wider range of feasibility expenditure fell within the meaning of exploration expenditure in section 37 of the PRRTAA. The Commissioner will communicate to Industry and affected taxpayers how he will apply compliance resources in relation

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	offset an amount of assessable receipts before that time. This is because: • To apply the Ruling to such past payments would represent a serious U-turn on past practice and would contravene the principles of good management described in PS LA 2009/4[3] and would be inconsistent with PS LA 2011/27.[4] • There are potentially serious commercial and contractual consequences if the Ruling is applied to payments made in prior periods potentially giving rise to significant costs for the taxpayer. • Inequitable and differential treatment could apply to companies with virtually identical fact patterns. **The ATO should have known the general view held in industry** A general Industry approach was known to the ATO and was not thought to have been contested by the ATO. The position was consistent with TR 2010/D4 (on the basis that a discovery is not commercial until commercial viability has been established). This is fundamentally different to the position in TR 2013/D4 and it was only after the issue of this draft that an informed understanding of the ATO's new public position on the definition of 'exploration' for PRRT purposes was obtained. **TR 2010/D4 and PRMS guidelines should be considered** The principles contained in both TR 2010/D4 (Withdrawn) (applying a	to expenditure incurred on or before 21 August 2013. Given the Ruling is to apply consistently with the submissions received (from 21 August 2013), comments have not been provided on whether the Commissioner agrees or disagrees with the matters raised in support of the approach advocated for.

[3] Law Administration Practice Statement PS LA 2009/4 *Escalating a proposal requiring the exercise of the Commissioner's power of general administration*.
[4] Law Administration Practice Statement PS LA 2011/27 *Matters the Commissioner considers when determining whether the ATO view of the law should only be applied prospectively*.

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	reading that is consistent with normal industry practice) and the published Petroleum Resource Management System guidelines should form the basis of determining deductibility for expenditure incurred in earlier periods. **Absence of Published ATO view** Absence of a published ATO view on the meaning of 'exploration' in the PRRTAA meant that taxpayers may have sought to rely on their understanding of the ATOs view of 'exploration' in the ITAA (as expressed in TR 98/23). **The ATO should not depart from PS LA 2011/27 despite the Full Federal Court decision in the *Macquarie Bank case*** That the *Macquarie Bank case* should not be interpreted by the Commissioner as somehow allowing the Commissioner to depart from the principles set out in PS LA 2011/27 as: • There was nothing in paragraphs 10 to 15 of the discussion paper (outlining the Commissioner's duty and powers) that is inconsistent with the *Macquarie Bank case*. • The *Macquarie Bank case* should be considered as only supporting the principle that a taxpayer cannot seek to effectively change the law by seeking to enforce the ATO to apply the principles in PS LA 2011/27 and the case should not apply, for example, in the context of the date of effect of a Public Ruling which is a broader and separate issue. It would be contrary to the genesis of the practice statement (Inspector General of Taxation working with the ATO, with input from Industry and Tax professionals to develop a mechanism to ensure that in determining the date of effect of its advice products, the ATO is guided	

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	by a clearly stated set of principles and criteria and that the decision making process is transparent and instils public confidence). See also the March 2010 Inspector General of Taxation report *Review into delayed or changed Australian Taxation Office views on significant issues.*	