TD 2018/D2 - Income tax: what constitutes 'use' (and potentially first use) of a mining, quarrying or prospecting right, that is a depreciating asset, for the purposes of subsection 40-80(1) of the Income Tax Assessment Act 1997 ?

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Draft Taxation Determination

Income tax: what constitutes 'use' (and potentially first use) of a mining, quarrying or prospecting right, that is a depreciating asset, for the purposes of subsection 40-80(1) of the *Income Tax Assessment Act 1997*?

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Ruling

1. You 'use' a mining, quarrying or prospecting right (MQPR) when you do something that the MQPR permits or authorises.

2. Merely holding, or meeting the conditions or requirements to hold, or retain, an MQPR does not constitute a 'use' of it. For example, designing an exploration plan to meet the requirements for holding an exploration right would not amount to a 'use' of that right, whereas exploratory drilling on the tenement would be a 'use' of the right.

3. To determine whether a particular action amounts to a 'use' of an MQPR, we must look to the terms of that MQPR. Ordinarily, it would require activity in the area over which the MQPR is granted.

4. Activities that are neither permitted nor authorised by the MQPR, or that you could undertake without holding the MQPR, are not a 'use' of the MQPR.

5. We accept that a holder of an MQPR can 'use' an MQPR where another entity (for example, a joint venture partner or a contractor) who is authorised by the holder does an activity on its behalf that would have been a 'use' if done by the holder.

6. There is no explicit requirement that the 'use' must exploit the inherent characteristics of the MQPR. However, a trivial act on the tenement will not amount to a 'use' because the law does not concern itself with trifles.

Example 1 – non-trivial use of an MQPR

7. *A state government grants an exploration licence over an area of land to Explore Co, which authorises them to conduct exploration activities.*

8. *Explore Co conducts exploratory drilling in the licence area, and is only authorised to carry out this activity because they hold the exploration licence. Explore Co has carried out a non-trivial activity which is authorised by the exploration licence, and which they would not be entitled to carry on but for that licence. Explore Co has 'used' the exploration licence for the purposes of subsection 40-80(1) of the Income Tax Assessment Act 1997 (ITAA 1997).*[1]

Example 2 – aerial survey for which an MQPR is not required

9. *A state government grants Digg Mining Ltd (DML) a mining right over an area of land which authorises DML to conduct exploration activities in the licence area.*

10. *DML conducts an aerial survey of the land. Under the State's laws, DML could have conducted the aerial survey without holding the mining right and it does not require access to the tenement. Following the aerial survey, geologists at DML's corporate headquarters analyse the survey data to start developing an exploration plan.*

11. *DML's aerial survey does not constitute a 'use' of its mining right under subsection 40-80(1), as DML would have been entitled to do the survey without holding the right, and it does not involve any access to the tenement itself.*

12. *DML's analysis of the survey data also does not constitute a 'use' of its mining right under subsection 40-80(1). DML would have been entitled to analyse survey data even if it did not hold the mining right. Furthermore, the data analysis is not done on the relevant land.*

Example 3 – access routes and trivial vs non-trivial activities

13. *A state government grants an exploration licence over land to Top Resources Ltd (TRL) which authorises TRL to conduct exploration activities on the land and to use the land to access adjacent tenements. TRL has no other interest in the land.*

14. *Frank, an employee of TRL, drives across the land to get to an adjacent tenement. While Frank has done something on the land that he would not have been entitled to do if TRL did not hold the exploration licence, driving across the land to simply gain access to an adjacent tenement is an activity that can be reasonably seen as being purely incidental and irrelevant to the other activities permitted by the licence. It is therefore a trivial activity which does not amount to a 'use' of TRL's exploration licence.*

15. *Six weeks later, Frank drives onto the land, collects soil and water samples and marks out an area for exploratory drilling. Frank is only permitted and authorised to carry out these activities because TRL holds the exploration licence. These activities constitute a 'use' of TRL's exploration licence as they are permitted and authorised by the licence and are non-trivial in nature as they can be reasonably seen as being relevant to the activities permitted by the licence.*

[1] All legislative references in this draft Determination are to the *Income Tax Assessment Act 1997*, unless otherwise specified.

Example 4 – meeting with native title holders in exploration licence area

16. *A Mining Co (AMC) holds an exploration licence over an area of land. Four contractors engaged by AMC enter the land to meet with native title holders to discuss the company's exploration proposals. The meeting is held on the tenement (rather than somewhere else) so the parties can inspect particular sites.*

17. *AMC's exploration licence permits this use of the land and the company would not have been able legally to access the land of its own accord if the licence had not been held. AMC's activity on the land is not trivial as it can be reasonably seen as being relevant to the activities permitted by the licence. Therefore, holding the meeting in the licence area constitutes a 'use' of the licence for the purposes of subsection 40-80(1).*

Date of effect

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

19. In addition, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
13 June 2018

Appendix 1 – Explanation

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

20. Generally, Division 40 provides deductions for the decline in value of a depreciating asset a taxpayer holds over the asset's effective life.[2]

21. By contrast, under section 40-80 the decline in value of a depreciating asset a taxpayer holds is the asset's cost where certain requirements are met. Two of these requirements are:

- the taxpayer must first 'use' the asset for exploration or prospecting for minerals, or quarry materials, obtainable by mining and quarrying operations[3], and
- when the taxpayer first uses the asset they do *not* 'use' it for development drilling for petroleum, or operations in the course of working a mining property, quarrying property or petroleum field.[4]

22. A 'depreciating asset' is defined to include 'mining, quarrying or prospecting rights'[5] (if they are not trading stock).[6]

23. 'Use' is not defined in the ITAA 1997. 'Use' is a word of wide import and its meaning in any particular case depends on the context in which the word is employed and the purpose for which the thing in question has been acquired or created.[7]

24. There are a number of possible meanings of 'use' for intangible assets, such as MQPRs, that cannot be physically used. However, the meaning of 'use' in section 40-80 cannot be taken in isolation and must be read in the context of the composite phrase *'you first use the asset for exploration or prospecting for minerals or quarry materials'*.

25. In the context of subsection 40-80(1) we consider that 'use' has both a conceptual and practical aspect.[8] The conceptual aspect is that it embraces a conventional view about the way a 'right' is used, by having regard to something that the right permits or authorises (or which would be illegal if done and the right were not held). The practical aspect is the requirement that something be done that the right authorises or permits. In our view, this approach to 'use' and 'first use' in the context of subsection 40-80(1):

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[2] The deduction is reduced to the extent the asset is used for a purpose other than a 'taxable purpose': subsection 40–25(2).
[3] Paragraph 40–80(1)(a).
[4] Paragraph 40–80(1)(b).
[5] A 'mining, quarrying or prospecting right' is defined in subsection 995–1(1) and includes an authority, licence, permit or right under an Australian law (or a lease of land that allows the lessee) to mine, quarry or prospect for minerals, petroleum or quarry materials, or an interest in such an authority, licence, permit, right or lease.
[6] Paragraph 40–30(2)(a).
[7] *Council of the City of Newcastle v. Royal Newcastle Hospital* (1957) 96 CLR 493.
[8] In *Mitsui v. FCT of T* [2001] FCA 1423, Siopis J discussed the concept of first use in section 40–80. His Honour's observations, which are not part of the ratio of the case, were made in the context of considering a hypothetical scenario that Counsel for the taxpayer argued exposed an anomaly in the Commissioner's position. It is acknowledged that his Honour's observation that section 40–80 may not apply to the production licence in the hypothetical scenario might be understood to support the proposition that merely holding an MQPR is a use of the asset. However, this point was not expressly made by Siopis J, and was in the context of a hypothetical scenario that was not in issue in that case.

- sets an appropriate test for determining whether the asset's decline in value is the asset's cost under section 40-80
- is capable of applying, and applying consistently, whether a depreciating asset is tangible or intangible
- recognises that an MQPR, by its nature, cannot be separated from the area over which it is granted. An MQPR authorises or permits the holder to carry on activities within the relevant area that the holder would not otherwise be entitled to carry on, and
- recognises that the 'first use' of a relevant depreciating asset must be identifiable, and able to be tested objectively against the requirements set out in paragraph 21 of this draft Determination.

26. There is a well-established principle that the law disregards certain things as *de minimis*.[9] For example, in *Wilks v. Goodwin*[10], Banks J said the principle applies where something is 'so trifling in value, or in amount, as to be negligible. Whether the *de minimis* principle applies will depend on all the facts and circumstances of each particular case. As a guide, activities that can be reasonably seen as being purely incidental, accidental or irrelevant to the other activities permitted by the MQPR will ordinarily be *de minimis* or trivial, and thus not a 'use' of the MQPR for the purposes of subsection 40-80(1). For example, while accessing an exploration licence area in order to take photographs for a company's annual report may strictly speaking involve exploiting the exploration right, it would be seen as so trivial that it does not amount to 'use' of that mining right.

[9] See for example, *Farnell Electronic Components Pty Ltd v. Collector of Customs* (1996) 142 ALR 322 per Hill J at 324-327, *National Mutual Life Association v. FC of T* 70 ATC 4134 per Gibb J at 4137 and *Industry Research and Development Board v. Unisys Info Services* 97 ATC 4848 at 4852.
[10] [1923] All ER 61.

Appendix 2 – Your comments

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

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

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

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2017/1

Legislative references:

- ITAA 1997
- ITAA 1997 Div 40
- ITAA 1997 40–25(2)
- ITAA 1997 40–30(2)(a)
- ITAA 1997 40–80
- ITAA 1997 40–80(1)
- ITAA 1997 40–80(1)(a)
- ITAA 1997 40–80(1)(b)
- ITAA 1997 995–1(1)

Cases relied on:

- Council of the City of Newcastle v. Royal Newcastle Hospital (1957) 96 CLR 493
- Mitsui & Co (Australia) Ltd v. Federal Commissioner of Taxation [2011] FCA 1423
- Farnell Electronic Components Pty Ltd v Collector of Customs (1996) 142 ALR 322
- National Mutual Life Association v. Federal Commissioner of Taxation 70 ATC 4134
- Industry Research and Development Board v Unisys Info Services 97 ATC 4848.
- Wilks v Goodwin [1923] All ER 61

ATO references

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