TR 92/19 - Income tax: exemption of income derived by bona fide prospectors

Australian Taxation Office

Taxation Ruling
Income tax: exemption of income derived by bona fide prospectors

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IT 2642

*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

contents para

What this Ruling is about

1. This Ruling explains:

   (a) what is required for a taxpayer to fall within the terms of the statutory definition of bona fide prospector under paragraph 23(pa) of the *Income Tax Assessment Act 1936* (the ITAA);

   (b) what are rights to mine for the purposes of paragraph 23(pa); and

   (c) what consideration is exempt and what is assessable under paragraph 23(pa).

Ruling

Prospecting

2. The term 'prospecting' means the same thing for the purposes of paragraph 23(pa) as it does in Division 10, including subsection 122J(6). It is explained in Taxation Ruling IT 2642.

Field work of prospecting

3. The test to determine whether a taxpayer (individual or company) is a bona fide prospector for the purposes of paragraph 23(pa) only applies to the 'field work of prospecting' and not other activities that are part of prospecting but are not field work, by the terms of subparagraph 23(pa)(i) or 23(pa)(ii).

Major part

4. The taxpayer must have carried out more than one-half the field work of prospecting to have carried out the 'major part' of that work in terms of subparagraph 23(pa)(i) or 23(pa)(ii).

Previous field work

5. If an area has been prospected previously, then the taxpayer must have done more field work of prospecting than has been done by the taxpayer's predecessors in total. The rights a taxpayer sells define the field work that counts. Field work of prospecting for gold, metals or minerals for which the taxpayer does not sell, transfer or assign their rights to mine is irrelevant. However, field work of prospecting simultaneously for several materials counts as relevant field work when considering the disposal by a prospector of rights to mine any of them.

Measuring field work

6. Field work can often be conveniently measured by its cost. However, this is only an indication and the number of worker hours and the type of equipment used in the field is considered to be a more accurate measure.

Future field work

7. Field work carried out after a prospector disposes of rights to mine the relevant material doesn't affect the prospector's claim to have carried out the major part of the field work when the rights were disposed of.

Development

8. The term 'development' in subparagraph 23(pa)(i) relates to the activities of prospecting development and not to the wider activity of mining development.

Personally or itself

9. The field work of prospecting must be carried out by the taxpayer:

- personally - if the taxpayer is an individual; or
- itself - if the taxpayer is a company.

As a company can act only by its agents, a company can satisfy the test by work done by any agent, including employees or subcontractors. However, an individual does not act personally if the individual uses an agent.

Partnerships

10. Each partner that is a company is a bona fide prospector for the purposes of the definition if the partnership has carried out the major part of the field work of prospecting while the company was a member of the partnership.

New partners

11. A new partner that is a company entering a partnership will not become a bona fide prospector until the partnership has performed more field work of prospecting than was done before the company entered the partnership.

Joint ventures

12. Joint venturers who do not carry out the field work of prospecting, or a major part of it, are only bona fide prospectors if they are individuals (persons) contributing to the cost of prospecting and development. Joint venturers who are companies carry out only their share of the field work performed by an agent of the venturers.

Expenditure incurred

13. Instead of a taxpayer who is an individual doing the field work personally the taxpayer may also satisfy the definition of a bona fide prospector by a second test. This test is satisfied where the taxpayer is a contributor to the expenditure incurred in the work of prospecting and development. A company may only satisfy the definition by doing the field work of prospecting itself.

Rights to mine

14. A person who has an authority to prospect or an exploration licence and has marked out and pegged an area is regarded as having 'rights to mine' within the meaning of paragraph 23(pa). Where a prospector (though not having pegged a claim) is nevertheless assured of being able to obtain a mining lease for him/herself or an assignee due to a significant find then it is also accepted that a right to mine within the meaning of paragraph 23(pa) exists.

Consideration received

15. Only the consideration received for the taxpayer's right to mine falls within paragraph 23(pa). Consideration received for other things, for instance, plant or mining equipment or for mine development work that is not part of prospecting, is not exempt. Where a taxpayer sells rights to mine for a number of metals and minerals in an area, some of which are prescribed metals or minerals and some of which are not, then only that part of the consideration received that relates to the rights to mine for the prescribed metals and minerals may be exempt. That part of the consideration will generally be determined by reference to the true value of the different rights to mine.

Partial sale

16. The consideration received for the sale, transfer or assignment of a fractional interest of a taxpayer's rights to mine is considered to come within paragraph 23(pa) if the other tests are satisfied.

Options

17. The granting of an option to purchase a taxpayer's right to mine is not the sale, transfer etc., of a right to mine and income derived from the granting of such options does not come under paragraph 23(pa).

Exempt consideration

18. Only that consideration which is in excess of the sum of the deductions claimed under Div.10 for exploration and prospecting is exempt.

Transition provisions

19. Subsection 122J(4E) is a transition provision from the time when only expenditure up to the amount of assessable income received from the mining project could be claimed as an allowable deduction in any year of income. The effect of the section is to reduce the residual expenditure amount which related to exploration and prospecting by the corresponding amount of income received for the disposal of rights to mine which were exempt under para.23(pa).

Trustees

20. Trustees will be subject to the same tests as individuals and companies, as the case may be. Beneficiaries will be subject to the normal operation of Div 6 of Part III of the ITAA.

Capital gains tax

21. Consideration which is not income and hence not exempt under para.23(pa) is subject to capital gains tax.

Date of effect

22. Generally, this Ruling applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued. However, if a taxpayer has a private ruling on the sale, transfer, or assignment of the taxpayer's rights to mine in a particular area, and that private ruling is inconsistent with this Ruling, then this Ruling will only apply to sales, transfers or assignments made after the date of this Ruling unless the taxpayer asks that it apply to earlier transactions.

Explanations

23. Paragraph 23(pa) provides that the income derived by a bona fide prospector from the sale, transfer or assignment of rights to mine for gold or a prescribed metal or mineral is exempt from income tax. This provision was inserted in 1977 to restore the previous income tax exemption under the former paragraph 23(p). The exemption's purpose is to encourage genuine prospectors to explore for metals or minerals and to dispose of their interests in any finds to other parties in a better position to commercially develop such finds.

24. Paragraph 23(pa) has a strictly limited application. It is also slightly different from the former paragraph 23(p) and hence care should be taken when looking at case law interpreting the meaning of bona fide prospector prior to 1977. It does not apply to all prospectors nor to all prospecting income. It only applies to cases where:

. the taxpayer can show that it falls within the terms of the statutory definition of bona fide prospector;

. the income is attributable to the sale of the taxpayer's rights to mine; and

. these rights are for the extraction of gold and certain metals or minerals as prescribed in the Income Tax Regulation 4.

25. A bona fide prospector is defined in paragraph 23(pa) for the purpose of a particular disposal of rights to mine for particular materials in a particular area. The materials are gold, any of the prescribed metals, or any of the prescribed minerals. A bona fide prospector is:

. an individual (person other than a company) who has personally carried out the whole or major part of the field work of prospecting for the particular materials in the particular area;

. an individual (person other than a company) who has contributed to the expenditure incurred in the work of prospecting and development in that area; or

. a company which has itself carried out the whole or major part of such field work.

A company which only contributes to the expenditure incurred in relevant prospecting and development is not a bona fide prospector.

26. The status of bona fide prospector only exists for the time, place and mineral for which the tests are satisfied. It is not a general classification under which once achieved a taxpayer can enjoy that status at all times and for all the areas for which he or she has rights to mine.

Prospecting

27. Paragraph 23(pa) does not define the term prospecting. However for the purposes of Division 10 (the mining and quarrying provisions), at subsection 122J(6), 'exploration or prospecting' is defined to include searching for areas containing minerals, for minerals in those areas, and for ore in or near an ore-body, but to exclude operations in the course of working a mining property. This definition is considered to reflect the correct meaning of prospecting for paragraph 23(pa) purposes. The definition is explained in IT 2642; in general, it includes all work done to the point where a decision to mine is made, and after that includes only activities that are not operations in the course of working a mining property.

Development

28. What is meant by 'development' as it relates to prospecting? There is no statutory definition of the term development in the income tax law, but it was judicially recognised by the Privy Council in

Douglas v Baynes [1908] AC 477 in the context of exploration and prospecting as meaning:

> 'the stage of work on mineralised ground which intervenes between prospecting and mining proper. First the ground is prospected in order to ascertain whether there are minerals in paying quantities. Then it is developed in order to test whether the minerals which have been found are such as to warrant the working of the property as a mining proposition. When that has been established, the property is actually worked and the minerals are extracted.'

In other words, it is the activity of determining the extent of the ore-body as a preliminary step to the extraction of metals and minerals. The decision to go into production is dependent on this work.

29. Division 10 does not specifically use the term 'development' but it does make a distinction between exploration and prospecting expenditure and development mining expenditure. As a general rule, prospecting or exploration in the context of Division 10 ceases when a decision is made to undertake mining operations. The term 'development' is usually applied to work undertaken after a decision has been made to mine the ore body, in carrying out the physical works which are a necessary prelude to the extraction or in extending mine workings to gain access to new sections of an ore body. This sort of development is part of the working of a mining property: see Taxation Ruling IT 2642, paragraphs 19-24.

30. On examination of the explanatory memorandum accompanying the amendments to the Act in 1947 (No.11 of 1947) it is apparent that the legislators intended that the exempt income under paragraph 23(p) (now para.23(pa)) be directly related to the same activities that were allowable as an outright deduction under section 123AA (now s.122J). That is the activities under paragraph 23(pa) are the same activities as in section 122J for exploration and prospecting. Hence the term 'development' in paragraph 23(pa) relates to the activities of prospecting development and not the wider activity of mining development.

Field Work

31. The test for a bona fide prospector relates to the 'field work of prospecting' and not just to prospecting in general. In *Biggs v. FC of T* 75 ATC 4172; (1975) 5 ATR 505, Wickham J in interpreting the former paragraph 23(p) said that field work means exactly what it says. He considered that there may be activities that are prospecting but not field work of prospecting.

32. The *Macquarie Dictionary* describes 'field work' as work done in the field, such as that of a prospector. Based on this description it is considered that only work either done on, above (aerial surveys) or below (drilling and shafts etc.) an area (the tenement) is applicable. Work done at a prospector's office, home, the title office, a laboratory (regardless of its location) etc., is not part of the field work of prospecting.

33. As to what constitutes the 'major part' of the field work of prospecting, the provision does not prescribe the extent of the prospecting which has to be carried out in the area. The requirement is relative only, and if the taxpayer is dealing with an area which has been prospected before, it does not matter how much field work is done (for example, one day or even an hour) so long as the taxpayer has done the major part of it.

34. In the case of an individual it would be necessary for the taxpayer to demonstrate that the taxpayer personally carried out more than one-half of the field work of prospecting (but an individual may qualify as a bona fide prospector by contributing to the expenditure incurred in the work of prospecting and development in the area, too). Fieldwork cannot be personally carried out through an agent.

35. In the case of a company it would be necessary for the company itself to have carried out more than one-half of the field work of prospecting. A company can carry out the field work itself through an agent.

Previous field work

36. If it is an area which has been prospected previously, then the taxpayer must show that it did more than its predecessors did. The provision requires an examination of all the work done to the date on which the taxpayer disposes of rights to mine in relation to the tenement. That is, the test is a cumulative one that must be satisfied at the particular point in time that the disposal takes place.

37. A prospector disposes of rights to mine particular material in a particular area. To qualify for exemption under paragraph 23(pa), the prospector may have carried out the whole or major part of the field work of prospecting for the particular material (which may be gold, a prescribed metal or a prescribed mineral). If some field work has been done that doesn't relate to prospecting for the particular material, that field work is irrelevant. Only field work that relates to prospecting for material covered by the rights of which the prospector is disposing needs to be taken into account.

38. What of field work that relates to any of a number of materials? Such field work is part of the field work of prospecting for any of

those materials. It counts in full in working out whether a prospector has carried out the whole or the major part of the field work of prospecting for any one, or any number, of those particular materials.

39. Often prospectors dispose of their rights to mine all materials a particular area. Suppose such a prospector has prospected for (and found) a particular material, in an area which has previously been prospected thoroughly, but only for other materials. Does all the previous field work count in determining whether the prospector has carried out the majority of the field work relevant to the rights disposed of?

40. We consider that the exemption is meant to encourage prospectors to seek what others have overlooked, as well as to investigate totally new areas. So the materials sought by a prospector's own field work must be an object of any previous field work *before* the previous field work is taken into account. The form of disposal of rights to mine will not be decisive where the work the prospector has done is clearly more narrowly directed. The question under the legislation is what material, whether gold, prescribed metal or prescribed material, is the real subject of the rights to mine the prospector disposes of.

41. Some have suggested that, as relevant field work relates only to the area for which the taxpayer sells rights to mine, any field work done there under a different permit or a different right is irrelevant to the question whether the taxpayer has carried out the whole or the major part of the field work. That is not correct. Field work of prospecting in a particular area may be done under a variety of arrangements, including under rights or leases with different boundaries. The question is not what boundaries applied to the permit or right under which field work was done, but whether there is earlier field work which was the same physical area as that for which a prospector sells rights to mine.

Measuring field work

42. Field work may often be measured conveniently by its cost. However, in trying to determine whether a prospector has carried out a major part of the relevant field work, the cost of work carried out by others may not be comparable. The prospector may have charged more or less than the expense rates of other prospectors for similar work. The prospector must ensure that any comparison is fair, and the number of worker hours used in field work is considered to be a more readily comparable measure.

43. Often a prospector may have only limited information on the extent or character of field work carried out in the area by others. The prospector must obtain enough information to determine whether his or her own field work is the major part of the relevant field work; sometimes this may require a prospector to treat particular field work as relevant although it is not entirely certain that the work was relevant (the onus of proof is on the prospector). Where previous field work was undertaken some years before and there are no apparent private records of what prospecting activities were undertaken previously, the records as kept by the States' or Territories' mine departments will be regarded as the determinant evidence of past prospecting activities.

44. Early records may be poor. The paragraph requires that a bona fide prospector show they have done 'the whole or the major part' of the field work. If there is no reason to believe that other field work is of any greater extent than that of the prospector, the ATO will accept this, provided reasonable enquiries have been made by the prospector. However, the records of earlier exploration may record only the money spent on earlier field work. In that case, the comparison must be based on the records available; this may require use of expenditure as a measure if hours can't be reliably inferred. Some comments have suggested that a prospector could never show that 'the whole or the major part' of the field work had been done by them, because the possibility of unknown past field work could never be ruled out absolutely. As the taxpayer's claim need only be established on the balance of probabilities, a prospector can show who carried out the whole or the major part of the field work on the basis of the information available.

45. Prospectors may wish to take into account only field work for which they had access to the results. This is too restricted. If a prospector knows of other field work on the site, even if the results were not available, that field work must be taken into account in deciding whether the prospector carried out the whole or the major part of the field work.

46. A situation may arise where a bona fide prospector agrees to sell his or her rights to mine but prior to the sale the purchaser may wish to do some field work of prospecting to verify the worth of the claim. In such a situation the field work of the purchaser will not count. The prospecting must merely be to verify an already known discovery. However, where a prospector farms out or grants an option to another person to conduct field work with the right to purchase the whole or a percentage of the rights to mine in that area if a discovery is made then such field work will count.

47. The exemption is designed to encourage prospectors, who have done the prospecting themselves and made a worthwhile discovery, to dispose of the rights to mine where they lack financial backing to parties who can further develop the area. It was not designed to be a tax exempt windfall to prospectors where the work (and risk) was done by another.

48. A prospector may have carried out the whole or a major part of the field work at the time the rights to mine are sold, transferred or assigned. Any further field work after that disposal (by the prospector or by someone else) is irrelevant to the application of paragraph 23(pa). So further prospecting by future parties will not affect the status of a prospector when rights to mine are disposed of.

Personally or itself

49. The definition of a bona fide prospector in subparagraph 23(pa)(i) refers to an individual, other than a company, personally carrying out the field work of prospecting. That is the acts must have been done personally by the individual. The definition in subparagraph 23(pa)(ii) refers to a company itself doing the field work of prospecting. That is the acts must have been done by the company itself. A company doing work 'itself' is not the same as an individual doing work 'personally'.

50. The requirement that the taxpayer must do the field work of prospecting is not as critical for individuals as for companies, as there is a second test for individuals. Individuals need only contribute to the expenditure incurred in the work of prospecting to be bona fide prospectors (see paragraph 57). However, the requirement that an individual carry out the field work personally means that the work cannot be carried out by an agent.

51. The definition in subparagraph 23(pa)(ii) in referring to companies requires the field work to be carried out by the company itself. Does this mean that a company cannot contract out its prospecting activities? If so, a company could never be a bona fide prospector, as a company can act only by its agents. In *Colonial Mutual Life Assurance Society Ltd v The Producers and Citizens Co-operative Assurance Company of Australia Ltd* (1931) 46 CLR 41, Gavan Duffy CJ and Starke J in a joint judgment discussing the law of agency said that where there is a class of acts which the agent was employed to do on behalf of the company then those acts are in fact the acts of the company.

52. At all times the subcontractor must be acting on behalf of the taxpayer. Even where the subcontractor is not acting with apparent authority, if the taxpayer ratifies all the acts of the subcontractor, those acts become those of the taxpayer. In *Wilson v Tumman* (1843)

6 Man.& G. 236 at 242; 134 E.R. 879, Tindal CJ in discussing the law of agency said:

> 'That an act done by a person, not assuming to act for himself, but for such other person, without any precedent authority whatsoever, becomes the act of the principal if subsequently ratified by him, is the known and well established principle of law.'

53. Another important feature of agency is that the principal is liable for the acts of the agent acting as agent (see *Colonial Mutual Life Assurance Society* case). Thus where a company engages an independent subcontractor, for example, a consulting geologist to carry out a certain type of field work, it would be accepted (due to the law of agency) that the company itself has carried out the field work as long as the subcontractor is acting as the agent of the company. The company must retain control of the operation and be liable for the acts of the subcontractor.

Partnerships

54. The principles of agency are applied, without modification, to partnership law. That is, each partner is acting as an agent for each other partner and each partner, acting within the bounds of the business of the partnership, makes each other partner liable for that partner's actions. Each partner's acts are legally the acts of the other partners.

55. Accordingly, with a partnership of taxpayers, it cannot be said that any one partner alone has carried out any particular part of the prospecting done by the partnership. Any partner which is a company has carried out the field work by its agent, and so has done the work itself. But the partners who are not companies have not carried out the field work *personally*, and so are not bona fide prospectors on the basis of that work unless they satisfy the contribution test. That is the test of who has conducted the field work of prospecting is more strict for individuals than companies.

56. A new corporate partner entering a partnership does not become a bona fide prospector until the partnership has performed more field work of prospecting than was done before the partner entered the partnership. It cannot be said that the acts of the other partners before the new partner entered the partnership are also the acts of the new partner when the new partner enters the partnership. The partners were not acting on behalf of the new partner at the time the field work of prospecting was being conducted by the old partnership (see *Wilson v Tumman*).

Joint ventures

57. A common usage of 'joint venture' is as a general description of all methods by which taxpayers may be associated, including partnership, a separate company in which they own shares, trusts and so on. However, in the narrower sense, a joint venture is often described as an association between participants, in which each shares in kind the results of that association, which is not a partnership or trust and which is not incorporated. The venturers are not agents of each other. A distinguishing feature of such ventures is that participants do not share the profits resulting from the venture, but share only the product or result of the venture. Nor do they share joint liability; rather, they are liable for only their fixed share of the joint venturer's liabilities. Where venturers share the proceeds of joint sale, they are likely to be partners in law even though they seek to avoid that status by assuming only several liability for their individual shares of expenditure, by denying that they have the rights or liabilities of partners, and by providing for a division of gross proceeds: *Brian Pty Ltd v. UDC Ltd* [1983] 1 NSWLR 490 (CA); *UDC Ltd v. Brian Pty Ltd* (1985) 157 CLR 1 (HC). These comments refer to joint ventures of this narrower kind and that are not partnerships.

58. There are two common variants of the joint venture used in mining. In one, each venturer contributes particular parts of the whole project. Shares of the project, and so of its result, reflect agreed valuations of these contributions. In such arrangements, one participant may carry out all field work of prospecting. In the other variant, the participants appoint a manager or agent to carry on the project for the participants. The participants then pay their shares of expenses to the manager, in accordance with their shares in the project. (The manager may also be a participant in the venture.) In these arrangements, the field work of prospecting is carried out by the manager, or by agents employed by the manager.

59. In each case, the joint venture may carry out the whole or the major part of the field work of prospecting, yet the participants in the venture may not qualify as bona fide prospectors. Where the prospecting work is done by one venturer as his or her contribution to the venture, or where it is done by an agent for the venturers, the other venturers have not carried out that field work personally. (If they are individuals who are not companies, they may still qualify where they have contributed to the expenditure incurred in the work of prospecting and development.) If the work is done as a contribution to the venture, the other venturers have not carried out any part of the

work themselves; however, where the work is carried out by a manager for the venturers, each corporate venturer has carried out the work itself to the extent of its own share in the venture. Most venturers will not be bona fide prospectors.

60. Some joint venture arrangements have been suggested in which the mutual agency which is a feature of partnerships is also found. Such arrangements are not common, as joint and several liability for the whole of a venture's obligations would follow. In general, joint venture structures are used by participants to limit their exposure to one another's obligations or shares of the obligations of the venture. Mutual agency would lead to the same result, for the purpose of paragraph 23(pa), as partnership.

Expenditure incurred

61. As stated previously, an individual (not a company) may also satisfy the definition of a bona fide prospector by simply contributing to the expenditure incurred in the work of prospecting and development, not necessarily only the field work of prospecting. Thus the activities that are considered (may be funded) are much wider than for the first test which involved only the field work of prospecting. The term development has been discussed from paragraph 28 and field work from paragraph 31.

62. Thus in a joint venture or partnership of individuals (not companies) where an individual simply contributed the finance for the prospecting and development in an area and an other party did the actual prospecting in that area (and satisfied the major part of the field work of prospecting test), then that individual would also be a bona fide prospector.

63. The legislation in subparagraph (i) uses the phrase 'in that area' to define the area the right to mine is for when applying the major part of the field work of prospecting test. This same phrase is used in the contribution test in subparagraph (i). That is the contributions must relate to the same area for which the taxpayer sells rights to mine. If the legislators had intended that contributions to any mining tenement qualified the contributor as an eligible bona fide prospector, the reference to the area as in the first test would not have been necessary. It would have been sufficient merely to state that a person who has contributed to the expenditure incurred in the work of prospecting and development would be a bona fide prospector.

64. It should also be noted that the contributions must relate to prospecting *and* development. That is the contributions must have gone towards some of the prospecting activity at a minimum and not just development. The contributions must have been incremental to the actual prospecting activity.

Rights to mine

65. The exemption applies to income derived by a person from the sale, transfer or assignment of their rights to mine in a particular area for a particular mineral. Many prospectors have no more than a right to prospect or explore, rights which have different consequences in different parts of Australia. They may, as a matter of law or of practice, confer a right to acquire a mining tenement. Then the prospector has a right to a right to mine. If such prospectors sell their rights, have they sold rights to mine?

66. In an absolute sense, a right to a right to mine is not, itself, a right to mine. After all, one cannot commence mining operations in reliance on it. The fact that exploration and prospecting rights may include a formal right to take strictly limited amounts of material from a site is merely consistent with the needs of exploration and prospecting themselves, and is not itself a right to mine.

67. The exemption is not for selling the absolute or unfettered right to mine. It is for selling the prospector's rights to mine, such as they may be. In those circumstances, the right to a right to mine can be accepted as a right to mine, and income from its sale qualifies for exemption under paragraph 23(pa). The exemption applies the more clearly as the prospector takes further steps to formalise a right to mine, for instance, to apply for a mining permit or peg out a claim for that purpose (where claims are still pegged out).

Consideration received

68. Only the consideration received for the taxpayer's right to mine falls within paragraph 23(pa). Consideration received by the taxpayer for other things, for instance for mining plant or equipment or for any mining development done in the area that is not part of prospecting, does not fall within paragraph 23(pa) (see previous discussion on development).

69. Where a right to mine is disposed of with other things, the Commissioner expects the parties to apportion consideration between the different matters. If this is not done, the circumstances must clearly show what is the consideration for the disposal of the right to mine. Taxpayers should also note the potential application of the anti-avoidance provisions of the income tax law. If, for instance, the amount described as consideration for rights to mine exceeds the value of any find and the cost of exploration and prospecting, yet mining plant and development is transferred for no stated consideration, the exemption under 23(pa) is likely to apply to only a part of the consideration.

Partial sales

70. Prospectors do not always dispose of their rights to mine completely. Sometimes they part with only a part of those rights: perhaps for a period, or perhaps by giving a non-exclusive right to mine to another. Does paragraph 23(pa) exempt the consideration for a partial disposal of rights to mine? The explanatory memorandum and other extrinsic material for the introduction of the paragraph is silent on this question.

71. The paragraph is meant to provide a tax benefit to encourage prospectors. An approach which required them to part with every portion of their right to mine before they could obtain the benefit would deprive bona fide prospectors of a substantial part of their encouragement, particularly where the prospector wishes to retain as much as possible of the benefit of their work. As a general rule, taxation provisions that provide a benefit are not to be defeated by an illiberal approach: *FC of T v. Tully Co-operative Sugar Milling Assoc Ltd* 83 ATC 4495; (1983) 14 ATR 495, per Fox J at ATC 4500; ATR 500.

72. Therefore, in some circumstances partial disposals will clearly attract the benefit of paragraph 23(pa). For instance, where a prospector disposes of the right to mine only for a particular prescribed metal or mineral, the paragraph would apply to that disposal, even if the rights retained by the prospector are substantial

73. However, where a prospector assigns his or her rights to mine in such a fashion that they can be retrieved after a certain time or event then the paragraph would not apply. All interests (legal and equitable) in the rights must be disposed of. That is for the exemption to apply the disposition (of the rights disposed of) must be absolute.

Options

74. The granting of an option to purchase a taxpayer's 'rights to mine' is not the sale, transfer etc., of 'rights to mine'. It is the granting of a discretionary right to purchase at a future date the 'rights to mine'. Accordingly, income received from the granting of such options would not come under paragraph 23(pa). However, if the option is exercised, the exercise price (i.e. the consideration then due for the transfer, sale or assignment of the 'rights to mine') would fall under paragraph 23(pa).

Exempt consideration

75. When calculating the amount of exempt income under para.23(pa) all deductions allowed under section 122J of Div.10 of the ITAA in respect of expenditure on exploration or prospecting in the particular area (the area for which the rights to mine are being disposed of) are to be deducted from the amount received from the disposal of those rights. The consideration received up to the sum of deductions claimed under Div.10 for exploration and prospecting is assessable under subpara.23(pa)(iii). Only the excess amount, if any, will be exempt.

76. Subpara.23(pa)(iii) does not restrict its operation to only expenditure incurred in exploration or prospecting for gold and metals or minerals prescribed in Income Tax Regulation 4. All deductions allowed or allowable under Div10 for exploration or prospecting **in a particular area** are to be included when calculating a taxpayer's entitlement under para.23(pa).

77. No consideration will be exempt under the provision where a prospector controls a purchaser, a purchaser controls a prospector, or a third party controls both, in entering the transaction or in activities in connection with their mining rights. Subparagraph 23(pa)(iv) specifies this rule.

Transition provisions

78. How does subs.122J(4E) of Div.10 operate? Subs.122J(4E) is a transition provision from the time when only expenditure up to the amount of assessable income received from the mining project could be claimed as an allowable deduction in any year of income. The remainder had to be rolled over as residual expenditure to be deducted in future years against assessable income from the project. From 21 August 1984 this restriction no longer applied.

79. Subs.122J(4E) 's effect was to reduce the residual expenditure amount which related to exploration and prospecting expenditure by the corresponding amount of income received for the disposal of rights to mine and which was exempt under para.23(pa). Thus the taxpayer was denied future deductions against future assessable income. Once again the operation of this provision is not subject to the expenditure being apportioned between either: (a) two or more prescribed metals or minerals; or (b) prescribed and non-prescribed metals and minerals.

Trustees

80. Where the trustee is an individual then the trust will be subject to the same rules as applies to an individual prospector. Likewise, where the trustee is a company then the trust will be subject to the

same rules as applies to a company who is a prospector. Beneficiaries are subject to the normal operation of Div 6, Part III of the ITAA.

Capital gains tax

81. Paragraph 23(pa) only applies to income. Income is taken to be its normal common law meaning. Where a taxpayer disposes of rights to mine which are not income (e.g. the prospecting is a hobby) then paragraph 23 (pa) will not operate to exempt the consideration received even where the taxpayer would satisfy the tests as a bona fide prospector.

82. Is the consideration, if not exempt under paragraph 23(pa), subject to capital gains tax under Part IIIA of the ITAA? Subsection 160L(7) of the capital gains tax provisions states that:

> 'This part does not apply in respect of a disposal being a sale, transfer or assignment of rights to mine if paragraph 23(pa) applies in relation to the sale, transfer or assignment.'

Part IIIA applies to all disposals of assets unless specifically excluded (subsection 160L(1)). The consideration for the disposal of rights to mine, even if income, would still be subject to the operation of Part IIIA. However, subsection 160L(7) excludes the operation of Part IIIA where paragraph 23(pa) applies.

83. As discussed, paragraph 23(pa) applies only to consideration which is income. Thus paragraph 23 (pa) exempts consideration which is income under Part III (subject to subparagraph 23(pa)(iii)) and subsection 160L(7) excludes the operation of Part IIIA to that income. Due to paragraph 23(pa) not applying to consideration which is not income the operation of subsection 160L(7) does not apply and hence the consideration is subject to capital gains tax.

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- bona fide prospector
- capital gains tax
- development
- field work
- joint ventures
- major part
- options
- partial sales
- partial sales
- partnerships
- prospecting

- rights to mine
- subcontractors
- trustees

legislative references
- ITAA 23(pa); ITAA 122J(6);
- ITAA Pt III Div 6
- ITAA 160L

case references
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