Australian Government
Australian Taxation Office

Australian Taxation Office Legislative Instrument
Instrument ID: 2012/ITX/0021

A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Supply or Acquisition Made Under a Contract Subject to Preconditions) Determination 2012

Explanatory Statement

General Outline of Instrument

1. This instrument is made under subsection 29-25(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).[1]

2. The instrument is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

3. The legislative instrument is necessary to prevent the provisions of Division 29 and Chapter 4 applying in a way that is inappropriate in particular circumstances under a deferred transfer farm-out arrangement[2] to which Miscellaneous Taxation Ruling MT 2012/2 Miscellaneous taxes: application of the income tax and GST laws to deferred transfer farm-out arrangements, applies. As explained below at paragraphs 5 to 7, under a deferred transfer farm-out arrangement certain supplies and acquisitions are subject to preconditions being satisfied.

4. The circumstances of Division 29 and Chapter 4 applying inappropriately to a supply or acquisition made under a contract that is subject to preconditions is covered by paragraph 29-25(2)(f).

Relevance of Miscellaneous Taxation Ruling MT 2012/2

5. Miscellaneous Taxation Ruling MT 2012/2 explains how the GST and income tax law applies to a deferred transfer farm-out arrangement.

[1] All legislative references in this explanatory statement are to provisions in the GST Act unless otherwise specified.

[2] A deferred transfer farm-out arrangement means an arrangement where the transfer of the interest in the mining tenement from the farmor to the farmee occurs only if the farmee meets all of its exploration expenditure and payment (if any) commitments for the transfer of that interest and relevant Ministerial or other approvals are granted, and the arrangement is one to which Miscellaneous Taxation Ruling MT 2012/2 applies.

6. As explained in Miscellaneous Taxation Ruling MT 2012/2 (paragraph 32), the supply of the interest in the mining tenement by the farmor[3] is in return for the consideration provided by the farmee[4] of the exploration benefit that flows to the farmor from the farmee's exploration commitments and cash payments[5] (if any) made by the farmee upon the exercise of the right to acquire the interest or upon transfer of the interest.[6] However, the interest in the mining tenement is only transferred by the farmor if the farmee completes (at the farmee's discretion) the exploration and any payment commitments to earn that interest (the earn-in requirements) within the required time (the earn-in period) and exercises the right (option) to acquire that interest and all necessary approvals[7] are granted. These are effectively conditions that must be met if there is to be a supply of the interest in the mining tenement by the farmor and an acquisition of that interest by the farmee.

7. It is the nature of deferred transfer farm-out arrangements that a farmee may (and often does) cease exploration before the earn-in requirements have been met, in which case the farmee cannot exercise the right to acquire the percentage interest in the mining tenement.

Commencement

8. The legislative instrument commences on 24 August 2011 and will apply retrospectively.

9. Miscellaneous Taxation Ruling MT 2012/2 was published as a draft Miscellaneous Taxation Ruling (MT 2011/D2) on 24 August 2011 and the views in Miscellaneous Taxation Ruling MT 2012/2 will apply to arrangements entered into after that date.

10. The legislative instrument similarly applies to arrangements entered into after 24 August 2011 to ensure that the provisions of Division 29 and Chapter 4 do not apply in a way that is inappropriate for taxpayers who rely on the views expressed in Miscellaneous Taxation Ruling MT 2012/2.

11. The effect of the legislative instrument is to the advantage of affected taxpayers for the reasons explained at paragraphs 18 to 21 below.

12. Under subsection 12(2) of the *Legislative Instruments Act 2003*, this legislative instrument does not adversely affect the rights or liabilities of any person other than the Commonwealth.

Application

13. The instrument applies if a farmor and a farmee have entered into a deferred transfer farm-out arrangement after the commencement date of this instrument and the arrangement is covered by Miscellaneous Taxation Ruling MT 2012/2.

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[3] Farmor means the owner of an interest in a mining tenement who enters into a deferred transfer farm-out arrangement with the characteristics as set out in paragraph 13 of Miscellaneous Taxation Ruling MT 2012/2.

[4] Farmee means the other party who, along with the farmor, enters into a deferred transfer farm-out arrangement with the characteristics as set out in paragraph 13 of Miscellaneous Taxation Ruling MT 2012/2 and who undertakes exploration expenditure and payment (if any) commitments under that arrangement to earn an interest in the mining tenement.

[5] This does not include any payment(s) made for the supply of the right to acquire an interest in the mining tenement or any payment(s) made for the grant of exclusive use and access rights.

[6] The exploration benefit provided is also a supply made by the farmee to the farmor. This and the supply of the interest in the mining tenement is a barter transaction.

[7] For example, Ministerial or Foreign Investment Review Board approval.

14. This instrument applies on the basis that the farmor is not required to transfer the percentage interest in the mining tenement to the farmee unless and until the farmee satisfies the exploration expenditure commitments and exercises the right to acquire the interest.

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

What the instrument is about

16. The instrument sets out the attribution rules that override the basic attribution rules (under section 29-5) to attribute GST payable if a farmor receives an exploration benefit as consideration (or part of the consideration) for the supply of an interest in a mining tenement and before the farmor knows if the farmee will exercise the right to acquire that interest.

17. It also sets out the attribution rules that apply in place of the basic attribution rules (under section 29-10) to attribute input tax credits if the farmee exercises the right to acquire the interest in the mining tenement and this is a creditable acquisition for the farmee.

What is the effect of this instrument

Farmor

18. If the farmor accounts for GST on a basis other than cash (a 'non-cash basis'), the legislative instrument ensures that the GST payable on the taxable supply of the interest in the mining tenement is attributable to the tax period in which the farmee exercises the right to acquire the interest in the mining tenement. Effectively, a non-cash basis farmor and farmee can exchange tax invoices upon the farmee exercising the right to acquire the interest in the mining tenement and account for GST payable and claim any input tax credits in that tax period. To the extent that it is a barter transaction and the acquisitions are fully creditable, it is a wash[8] transaction for the farmor and for the farmee.

19. The legislative instrument ensures that if the farmor accounts for GST on a cash basis, the GST payable on the taxable supply of the interest in the mining tenement is attributable to the tax period in which the interest is transferred. This aligns with when a cash basis farmor can claim an input tax credit for the acquisition of the exploration benefit (assuming the farmee has issued a tax invoice[9] to the farmor for the exploration benefit by this time). If any of the consideration received is cash, the basic attribution rules apply.

[8] That is, the GST payable equals the input tax credit able to be claimed by each party.
[9] The farmor must hold a tax invoice to claim an input tax credit: subsection 29-10(3).

Farmee

20. The legislative instrument ensures that if the farmee accounts for GST on either a cash or a non-cash basis, the input tax credit for a creditable acquisition of the interest in the mining tenement is attributed to a tax period no earlier than the first tax period in which the farmor could issue the farmee with a tax invoice and the farmee could claim an input tax credit.[10] The legislative instrument ensures that the four year time limit for claiming input tax credits does not run from a tax period when the farmee could not claim input tax credits as at that time there is no certainty as to the farmee making an acquisition, and thus a creditable acquisition, and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply. Once a cash basis farmee exercises their right to acquire the interest in the mining tenement, the farmee may claim input tax credits to the extent of any consideration already provided. If a cash basis farmee provides further consideration after they have exercised their right, the input tax credit with respect to that further consideration is attributable according to the basic attribution rules.

21. The following examples illustrate how the attribution rules under this legislative instrument apply in conjunction with the basic rules under Division 29 (see also paragraphs 97 to 100 and 110 of Miscellaneous Taxation Ruling MT 2012/2).

Example

22. A farmor and a farmee have entered into a deferred transfer farm-out arrangement and Miscellaneous Taxation Ruling MT 2012/2 applies to the arrangement. Assume all amounts in this example are GST inclusive.

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

24. The market value of the interest in the mining tenement is $110,000 at the time of entering into the agreement. Based on the principles in Miscellaneous Taxation Ruling MT 2012/2 the value of the exploration benefit the farmor receives is $97,900 (which includes GST of $8,900). This is worked out as $110,000[11] less $11,000[12] cash payment upon exercise of the option less $1,100[13] which for GST purposes was consideration for the granting of the right.

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

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

[10] The farmee must hold a tax invoice to claim an input tax credit: subsection 29-10(3).
[11] The market value of the interest in the mining tenement.
[12] The cash payment.
[13] The amount of $1,100 is deducted because, upon the exercise of the right to acquire the interest in the mining tenement, the consideration is limited to any additional consideration that is provided (see subparagraph 9-15(3)(a)(i)).

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

Farmee – cash basis	Farmee – non-cash basis
$8,900 GST payable Under the basic rules (paragraph 29-5(2)(a)), the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. all of the consideration) is received by the farmee.	$8,900 GST payable Under the basic rules (paragraph 29-5(1)(a)), the GST payable is attributable to tax period 1, year 4 as this is when the interest in the mining tenement (i.e. any of the consideration) is received by the farmee. However, if the farmee issues an invoice in an earlier tax period, for example, in tax period 4, year 3, the GST payable is attributable to this earlier tax period (paragraph 29-5(1)(b)).
$9,900[14] input tax credit Under the legislative instrument, the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply.	$9,900 input tax credit Under the legislative instrument, the input tax credit is attributable to tax period 4, year 3. The farmee would also need to hold a tax invoice (subsection 29-10(3)) issued by the farmor to claim an input tax credit in this tax period. The farmee could not claim an input tax credit at an earlier point in time as there is no certainty as to making an acquisition and thus a creditable acquisition and the farmor can not issue a tax invoice due to lack of certainty as to any obligation to make a supply.
Net outcome Basic rules - $8,900 GST payable in tax period 1, year 4 Legislative instrument - $9,900 input tax credit claimable in tax period 4, year 3 provided a tax invoice is held in that tax period	*Net outcome* Basic rules - $8,900 GST payable in tax period 1, year 4; or tax period 4, year 3 Legislative instrument- $9,900 input tax credit claimable in tax period 4, year 3 provided a tax invoice is held in that tax period

Background

26. This instrument ensures that the attribution rules apply appropriately for a farmor entity that makes a taxable supply of an interest in a mining tenement and a farmee entity that makes a creditable acquisition of that interest under a deferred transfer farm-out arrangement as characterised in Miscellaneous Taxation Ruling MT 2012/2 (paragraph 13). The legislative instrument, in conjunction with Miscellaneous Taxation Ruling MT 2012/2, addresses concerns raised by industry associations as to how the GST law applies to deferred transfer farm-out arrangements and this included uncertainty as to the application of the attribution rules given the uncertainty as to the interest in the mining tenement actually being transferred.

Costing

27. Compliance cost impact: Low – minor or machinery in nature. The instrument will affect only entities within the mining industry that enter into a deferred transfer farm-out arrangement. It makes it clear how GST and input tax credits are attributable for that arrangement. There is no ongoing compliance cost impact and a low implementation impact reflecting the need for some taxpayers to be aware of the change and make some minor adjustments to their processes if entering into a deferred transfer farm-out arrangement'.

[14] That is, $8,900 plus $1,000.

Consultation

28. A draft legislative instrument and draft explanatory statement were included for public comment as part of the consultation on the related draft Miscellaneous Taxation Ruling MT 2011/D2. During development of both the draft and final Rulings consultation has been undertaken with the peak mining industry bodies (the Association of Mining and Exploration Companies (AMEC); the Australian Petroleum Production & Exploration Association (APPEA); and the Minerals Council of Australia (MCA)).

29. No comments were received in respect of the explanatory statement or the related legislative instrument.

Statement of Compatibility with Human Rights

30. This instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

James O'Halloran
Deputy Commissioner of Taxation

12 April 2012

Legislative references:

A New Tax System (Goods and Services Tax) Act 1999

9-15(3)(a)(i)

29-5

29-5(1)(a)

29-5(1)(b)

29-5(2)(a)

29-10(1)

29-10(1)(a)

29-10(1)(b)

29-10(2)

29-10(2)(a)

29-10(3)

29-25(1)

29-25(2)(f)

Legislative Instruments Act 2003
12(2)