Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates

2014 - 2015

Department/Agency: ATO
Question: AET 59-60
Topic: Farm-out arrangements
Reference: Hansard page 61-62
Senator: Ludwig

Question:

Senator LUDWIG: You may or may not be familiar with the intimate detail of the farm-out arrangements in MT 2012/2. I am happy for you to take it notice. Mr Mills may be more familiar with it. What I was trying to establish is, with the farm-out arrangements that occurred in the exploration industry, how much revenue do you collect or how much tax deductibility do you provide? You do it company by company, and I am not asking for that level of detail and nor would you provide it. I am trying to ascertain whether you do it by class or if you can break down those numbers a little bit or just simply a gross figure of what the tax deductibility in that transfer arrangement is. There is a farmee and a farmer in that sense, which occurs, and there is a percentage of the interest that the recipient receives. That is section 730(1), for those who are interested in the tax act.

Mr Mills: We will have to take that on notice.

Senator LUDWIG: I thought you might. Have I provided enough clarity about what I was after?

Mr Mills: Yes.

Senator LUDWIG: The second question relates to this area as well, which goes to deductions under section 40-730 of the Income Tax Assessment Act. This is about resource and exploration companies. I am just curious as to how you treat those tax deductions. To give you a bit more detail so you can get your head around it—there is tax deductibility for exploration. What I was trying to establish was the breakdown of that value or how you would put it of those tax deductibilities and whether you break it down by the way they can do it so there is a direct deduction or, alternatively, they can pass it on for year to year. There are different accounting standards that are used. There are two primary accounting standards that are used. One of them effectively means that a company can explore and get a tax deduction for it. Another one is where a company might put it in their balance sheet as an asset and hold it as an asset and then use that asset as security against loans or what have you. I was not so much interested in the company side of it but how the tax department treats those transfers and what tax deductibility is provided to the various companies in a grossed up sense. It would be good if you can break it down, but if you can only provide it in a gross amount I am happy with that too. I certainly do not want to explore individuals.

Mr Mills: There are obviously deductions available for exploration under a number of different sections. 40-730 is one of them. Are you looking for us to provide some analysis under those different provisions?

Senator LUDWIG: If you can provide some of the other provisions that would be helpful. These are the only ones I have been able to find. As you can appreciate, and not meaning to be sharp, it is a dense piece of legislation. If there are other provisions you can take me to them as well. I am not after a lot of work. If I want to follow it up even more I will come back in June.

Mr Mills: I will take that on notice.

Answers:

59. The ATO does not capture information specifically about revenue or deductibility relating to farm-out arrangements. There is no tax return label for deductions under farm-out arrangements. . Typically the ATO will first become aware of such an arrangement when undertaking compliance activity.

    Consequently, identification of the deductible amounts cannot be provided with any certainty.

60. From an accounting perspective, where exploration expenditure satisfies certain accounting requirements, the cost can be written off immediately as an expense. However, where these requirements are not satisfied the expenditure is capitalised and written off over the useful life of the asset.

    For income tax purposes, exploration-related expenditure might be deductible immediately under section 8-1 of the *Income Tax Assessment Act 1997* or under Division 40 (sections 40-80 or 40-730) dependent on its purpose, nature, source and timing.

    Section 8-1 does not apply to expenditure of a capital nature.

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Prior to 2014, section 40-80 applied to allow an immediate deduction for the full capital cost of depreciating assets, which include mining rights and mining information, acquired and first used for exploration. Where the requirements of section 40-80 are not met, section 40-25 otherwise applies to provide a decline-in-value deduction over the useful life of the depreciating asset.

Section 40-80 was amended in 2014 in respect of depreciating assets that are mining rights and mining information. Deductions in respect of the cost of those assets are now immediate only if they are acquired from specified sources. For example, the cost of a mining right acquired from the government as grantor is immediately deductible. Otherwise, the cost of these assets is now deductible over 15 years or the life of the mine (whichever is shorter).

Section 40-730 also provides an immediate deduction for expenditure of both a revenue and capital nature incurred on exploration that does not relate to the acquisition of a depreciating asset. Typically, section 40-730 concerns expenses incurred for geological mapping, geophysical surveys, searching by drilling and feasibility studies to evaluate the economic feasibility of exploiting discoveries.

As there are various sections under which exploration expenditure can be deducted, the ATO is unable to provide, with any certainty, an aggregate amount of deductions claimed for exploration expenditure. In particular, as section 8-1 is a general deduction provision, the specific reasons or basis for deductions claimed under this section are not captured by the ATO.