

6 February 2015

The General Manager
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Resource Project Realignment and Farm-Out Legislation

The Australian Petroleum Production & Exploration Association (APPEA) is the national body that represents companies engaged in oil and gas exploration and production operations in Australia. APPEA is pleased to provide the comments below, together with the attached material, in relation to the exposure draft material circulated by Treasury for stakeholder comment.

Part 1: Alignments

APPEA considers that there are three areas that need to be addressed or clarified if the proposed legislation contained in the Exposure Draft (ED) is to work as intended from a policy and tax technical perspective for the rollover relief.

1. Project or proposed project – To make it clearer and appropriately address industry situations without being too prescriptive, a project should be defined to include “a single project or proposed project or two or more such projects jointly undertaken by the same entities.”
2. “Reserves” – This “category” or terminology used by the industry is further along the project time line than as is envisaged in the ED. Typically, it is a term that applies once there is a sanctioned project. Realignment should be expected to occur earlier (although not always). The use of a different term, whilst remaining true to the policy intent, is required (see below and attached mark-ups to the ED).
3. In order to achieve the intended policy outcome, the ED must have provisions which effectively turn-off CGT events for arrangements which are regarded as interest realignment arrangements. In the case of depreciating rights which qualify for the roll-over, and also for CGT assets, there should be no unintended consequences arising from the contractual rights created and satisfied as part of a re-alignment. This is because of the potential breadth of the CGT provisions. It seems to be an oversight that this wasn’t included in the ED for the basic depreciating asset realignment case, nor for the CGT asset realignment case. It was however identified and covered in the proposed “interest realignment adjustment” provision- see 40-364 (3), (4), (5), (6).

In addition to the issues outlined below, there are also a number of comments and proposed changes to the legislation that are contained in the attached document.

Specific Issues

- As indicated above, the term ‘reserves’ has a specific meaning within the petroleum industry that is potentially in conflict with the use of the same word in the draft legislation. Specifically, in many cases, ‘reserves’ cannot exist until either a final investment decision has been made with respect to a project or a contract for the supply of petroleum has been secured with a buyer. Please see a proposed change included in the marked up comments in the draft legislation.
- APPEA requests the inclusion of a number for examples in the Explanatory Memorandum to address scenarios that we consider should be covered by the provision. This is based on both our understanding of the policy intention of the provision and the need to meet commercial practicalities (particularly in the case of project realignments). We recommend examples to permit, support and highlight the following scenarios:
 - where there may be more than one existing joint venture intending to form ‘the project’ (including proposed projects)
 - where a party (or parties) to the project/proposed project is not part of a joint venture
 - where one party has CGT interests and the other party has UCA interests in the same permits.
- Division 40 roll-over relief is elective (ss40-363(1)(d)), whereas CGT relief is automatic. There may be circumstances where a party to an alignment with pre-CGT assets is disadvantaged by automatic rollover relief. For example, if you also paid cash, under s124-1230 the recipient would not get rollover relief for the cash component but under 124-1225 and ITTP s40-77(1C), the cash would be treated as part of cost base of the new permit asset of the payor and you would not get UCA relief (see example 1.5 in the EM). Parties should be able to elect CGT rollover relief. Both parties do not need to elect rollover relief under 40-463 – therefore there does not seem to be any need for consistency of treatment for CGT.
- The measures are intended to operate with retrospective effect from 14 May 2013. APPEA supports the Government legislating in order to give effect to the proposed measures. In some circumstances, care may be needed, for example where the measures retrospectively alter lodged positions based on existing law. Administrative measures may be needed to support the implementation of enacted legislation in such circumstances. It is also possible that transitional arrangements may be necessary to ensure the measures operate as intended, in particular, in relation to the interest alignment adjustment provisions. They should not apply to rights created before May 2013 that come to an end after this date. For example, a CGT C2 event on receipt of a payment in respect of a right created before the date could be assessable under ss40-364(1) because the application provision states that the amendments apply to CGT events that occur after 14 May 2013. The new provisions should not change the tax outcomes for any arrangement entered before the start date.
- We recognise that the application and interaction of the income tax provisions for our Industry can be highly specialised and complex. The breadth of our capital gains tax provisions and their interaction with those concerning depreciating assets, for example, via the CGT anti-overlap rules, and the potential operation of residual CGT events

notwithstanding this, is a case in point. We would be pleased to provide further assistance in clarifying aspects of the interaction of the realignment rollover with existing tax provisions from a technical perspective.

More generally, and from an energy policy perspective, it is important that the taxation provisions do not operate in a manner that discourages petroleum exploration and development activities. The complex and changing nature of operations in the oil and gas industry necessitates ongoing engagement between industry and the Government to ensure distortions are not created through inefficient or inflexible taxation settings.

Part 2: Farm-Ins/Farm-Outs

- The definitions of “farm-in farm-out arrangement and “exploration benefit” in section 40-1135 require further consideration as marked on the attached Exposure Draft of the proposed Bill (see comments attached).
- The provision needs to be clear that farm-in/farm-out agreements are not constrained by the nature of the permit, lease or licence. For example, the provision should not be limited to an exploration permit – it should also apply to retention leases to the extent that the nature of the relevant activity relates to exploration activities.
- The draft legislation provides for a clawback of tax relief if there is a change in circumstances (for example, a free carry in a later period starts to cover development rather than exploration costs). The intent is clear in the Explanatory Memorandum (Paragraphs 1.73 through 1.75), but is less clear in the draft legislation.
- Clarification is sought on the status of the current taxation rulings. Specifically, does this mean that the rulings will be withdrawn? If so, as the rulings also cover GST implications (and the ED legislation does not), will guidance be provided on the GST implications on farm outs?
- The legislation is proposed to apply to farm outs entered into from 14 May 2013 (when the Federal Budget announcement was made regarding cessation of immediate deduction for acquired mining rights/information). It would therefore seem appropriate that the ATO allow taxpayers the opportunity to review and amend returns without penalty if they have not applied the legislation as drafted.
- Subsection 40-1135(2)(c) – no exploration benefit unless the spend would otherwise have been included in the cost of information, as another depreciating asset, or deductible under s40-730. For absolute clarity, this provision should also include that it could be deductible under s8-1.
- Subsection 40-1135(2)(a)(iii) finishes with “and” – should this be an “or”?
- The proposed changes appear based on the Commissioner’s position in the rulings that expenditure incurred by the farmee in meeting its commitments, including the funding of a

farmor's obligations, is deductible to the farmee when in respect of exploration. The preferred position is that this outcome is provided for in the amendments rather than relying on the Commissioner's current analysis and covered by an example in the EM that comprehensively dealt with the operation of the proposed provisions.

APPEA would be pleased to further expand on the issues contained in this letter. Contact is Noel Mullen (nmullen@appea.com.au).

Yours sincerely



David Byers
Chief Executive

Enc. Marked up comments on the Exposure Draft Legislation

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EXPOSURE DRAFT

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Inserts for

**Tax and Superannuation Laws
Amendment (2015 Measures No. 1) Bill
2015: Interest realignments and farm-in
farm-out arrangements**

Commencement information

Column 1	Column 2	Column 3
Provision(s)	Commencement	Date/Details
1. Schedule #	The day this Act receives the Royal Assent.	
2.		
3.		

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1 **Schedule #—Tax relief for certain mining**
2 **arrangements**

3 **Part 1—Interest realignment arrangements**

4 *Income Tax Assessment Act 1997*

5 **# After section 40-362**

6 Insert:

7 **40-363 Roll-over relief for interest realignment arrangements**

8 *Circumstances giving rise to roll-over relief*

- 9 (1) There is roll-over relief if:
- 10 (a) there is a *balancing adjustment event under section 40-295
 - 11 because, in an income year, you dispose of a *depreciating
 - 12 asset to another entity; and
 - 13 (b) the asset is a *mining, quarrying or prospecting right; and
 - 14 (c) the disposal occurs under an *interest realignment
 - 15 arrangement; and
 - 16 (d) you choose to apply roll-over relief in relation to the asset.

17 *Choosing to apply roll-over relief*

- 18 (2) The choice must:
- 19 (a) be in writing; and
 - 20 (b) be made within 6 months after the end of the income year in
 - 21 which the *balancing adjustment event occurs, or within a
 - 22 longer period allowed by the Commissioner.

23 *The effect of roll-over relief*

- 24 (3) If there is roll-over relief under this section:
- 25 (a) section 40-285 does not apply to the *balancing adjustment
 - 26 event in relation to the asset; and
 - 27 (b) an amount is included in your assessable income if such an
 - 28 amount (the *non-realignment amount*) would have been
 - 29 included under subsection (1) [\[should this be “sub-section](#)
 - 30 [40-285\(1\)”?\]](#)if:

Comment [A1]: In the case of depreciating assets which qualify for rollover relief, there should be no unintended CGT consequences arising from the contractual rights created and satisfied as part of the interest realignment. The potential application of the CGT provisions needs to be switched off in the base case, where there is no “interest realignment adjustment”. This is because the CGT provisions can potentially apply more broadly to any residual aspects in an interest realignment arrangement.

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- (i) paragraph (a) of this subsection did not apply; and
- (ii) the *adjustable value of the *mining, quarrying or prospecting rights that you disposed of under the arrangement were taken to be the market value of the mining, quarrying or prospecting rights that you received under the arrangement; and
- (c) in working out the *cost of a mining, quarrying or prospecting right that you receive under the arrangement, if:
 - (i) some or all of the cost consists of a *non-cash benefit that you provide; and
 - (ii) that benefit is a mining, quarrying or prospecting right that you disposed of under the arrangement; the market value of the benefit is taken to be the adjustable value of the benefit.
- (4) The amount included in your assessable income under paragraph (3)(b) is the non-realignment amount, and it is included for the income year in which the balancing adjustment event occurred.

Meaning of interest realignment arrangement etc.

- (5) An **interest realignment arrangement** is an *arrangement:
 - (a) that is entered into between entities:
 - (i) that are undertaking jointly, or propose to undertake jointly, a project for carrying out *mining ~~and~~ quarrying operations (**the *project**); and
 - (ii) that each *holds *mining, quarrying or prospecting rights relating to **the project**; and
 - (b) under which those entities exchange (or agree to exchange), with the effect set out in subsection (6), parts of those rights; and
 - (c) that does not provide for any transfer of a mining, quarrying or prospecting right for a purpose other than giving rise to the effect referred to in subsection (6).
- (6) The effect referred to in paragraphs (5)(b) and (c) must be that, for each of those entities, the following are equal:
 - (a) the entity's percentage interest in the project;
 - (b) the reserves represented by the *mining, quarrying or prospecting rights that the entity *holds relating to the project, expressed as a percentage of the reserves represented

Comment [A2]: Refer over page for a proposed definition of project, to ensure that the concept is robust.

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Comment [A3]: Grammatically it seems "the project" referred to in s 40-363(5)(a)(ii) is the project considered in s 40-363(5)(a)(i). This would mean "the project" in s 40-363(5)(a)(ii) can be either proposed or existing.

One possible way to make this clear would be to make "the project" a defined term and use throughout, as suggested by the potential mark up in s 40-363(5)(a)(i).

However it is possible that the current wording is still too simplistic, hence the suggestion over the page.

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1 by all mining, quarrying or prospecting rights that any of the
2 entities hold relating to the project.

3 For the purposes of paragraph (b), the reserves represented by a
4 *mining, quarrying or prospecting right are taken to be the reserves
5 . contingent resources or *minerals, reasonably estimated using an
6 appropriate accepted industry practice, that are expected to be
7 extracted from the mine, *petroleum field or quarry to which the
8 right relates.

9 For the purposes of section 40-363, project includes a single project or
10 proposed project or two or more such projects jointly undertaken
11 by the same entities.

12 **40-364 Interest realignment adjustments**

13 *Effect of receiving interest realignment adjustment on assessable*
14 *income*

- 15 (1) If you receive an *interest realignment adjustment in an income
16 year, include in your assessable income for the year an amount (the
17 **adjustment amount**) equal to:
18 (a) the amount of the adjustment, or
19 (b) if the adjustment is not an amount—the *market value of the
20 adjustment.

21 *Effect of providing interest realignment adjustment on cost, or cost*
22 *base and reduced cost base*

- 23 (2) If an *interest realignment adjustment is provided by you or on
24 your behalf:
25 (a) include the adjustment amount in the second element of the
26 *cost of a *mining, quarrying or prospecting right that you
27 acquired under the *interest realignment arrangement to
28 which the adjustment amount relates; or
29 (b) if this Division does not apply to that right—include the
30 adjustment amount in the *cost base and *reduced cost base
31 of that right.

32 However, if your acquired more than one such right under the
33 arrangement, apportion the adjustment amount between the costs,
34 or cost bases and reduced cost bases, of those rights on a
35 reasonable basis.

Comment [A4]: Given “reserves” has a particular meaning within the oil and gas industry, we suggest it would be helpful to clarify as proposed if the intent is broadly that this test is applied by taking into account the expected resources in situ within the boundaries of the mining, quarrying or prospecting right.

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1 | Note: Subsections 40-477(1D) and (1E) of the *Income Tax (Transitional*
2 | *Provisions) Act 1997* set out when this Division does not apply to the
3 | right.

4 | *Tax effects of the right to an interest realignment adjustment*

- 5 | (3) In calculating the *termination value of a *mining, quarrying or
6 | prospecting right that you provide under an *interest realignment
7 | arrangement, assume to be zero the *market value of any
8 | contractual right conferred by the arrangement to an *interest
9 | realignment adjustment to be received by you.
- 10 | (4) In calculating the *cost of a *mining, quarrying or prospecting right
11 | that you receive under an *interest realignment arrangement,
12 | assume to be zero the *market value of any contractual right
13 | conferred by the arrangement to an *interest realignment
14 | adjustment to be provided by you.
- 15 | (5) The creation of a right to an *interest realignment adjustment does
16 | not cause *CGT event D1 or D3 to happen.
- 17 | (6) Your receipt of an *interest realignment adjustment does not cause
18 | *CGT event C1 or C2 to happen in relation to the right to receive
19 | the adjustment.

Comment [A5]: For completeness.

Comment [A6]: For completeness.

Comment [A7]: These provisions do not appear to technically extend to apply to subdivision 124-S. A similar provision should be included in subdivision 124-S.

20 | *Meaning of interest realignment adjustment*

- 21 | (7) An *interest realignment adjustment* is an amount, or an asset
22 | (other than a *mining, quarrying or prospecting right), that:
23 | (a) is provided under an *interest realignment arrangement to a
24 | party to the arrangement by or on behalf of another party to
25 | the arrangement; and
26 | (b) is provided as an adjustment, to the parties' contributions of
27 | value to the project to which the arrangement relates, that
28 | arises because information that has become available since
29 | the time the arrangement took effect indicates that the other
30 | party did not make an appropriate contribution at that time.

31 | **# At the end of Division 124**

32 | Add:

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Subdivision 124-S—Interest realignment arrangements

Guide to Subdivision 124-S

124-1220 What this Subdivision is about

There is roll-over relief if an interest in a mining, quarrying or prospecting right is disposed of under an interest realignment arrangement.

Table of sections

124-1225	Disposals of interests under interest realignment arrangements
124-1230	Rollover consequences—partial roll-over
124-1235	Roll-over consequences—all original interests were post-CGT
124-1240	Roll-over consequences—all original interests were pre-CGT
124-1245	Roll-over consequences—original interests were of mixed CGT status, all were pre-UCA
124-1250	Roll-over consequences—some original interests were pre-UCA

Operative provisions

124-1225 Disposals of interests under interest realignment arrangements

- (1) There is a roll-over if:
- (a) *CGT event A1 happens because you dispose of one or more assets each of which:
 - (i) is an interest (an *original interest*) in a *mining, quarrying or prospecting right; and
 - (ii) is an interest that you started to hold before 1 July 2001; and
 - (b) the disposal occurs under an *interest realignment arrangement.
- (2) The first element of the *cost base and *reduced cost base of the an interest (a *new interest*) in a *mining, quarrying or prospecting right that you acquire under the *interest realignment arrangement includes any amount you paid to get it (which can include giving property: see section 103-5).

Note 1: The rest of the first element is worked out under Subdivision 124-A.

Comment [A8]: This needs to be expanded to include other CGT events consistent with the Depreciation rollover. Also needs to ensure that the rollover extends to mining information which is also an asset we might acquire/dispose of with a piece of the permit, especially in a simple example where two Cos own 100% of their own permits and come together to own a % of each permit.
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Comment [A9]: Minor typographical error

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1 Note 2: Under subsections 124-10(2) and 124-15(2), a capital gain or capital
2 loss you make from an original interest is disregarded.

3 **124-1230 Rollover consequences—partial roll-over**

4 (1) You can obtain only a partial roll-over in relation to an original
5 interest if the *capital proceeds for that interest includes something
6 (the *ineligible proceeds*) other than a new interest or new interests.
7 There is no roll-over for that part (the *ineligible part*) of the
8 interest for which you received the ineligible proceeds.

9 Note: If there is more than one original interest, some or all of those original
10 interests may each have an ineligible part.

11 (2) The *cost base of the ineligible part is that part of the cost base of
12 the original interest as is reasonably attributable to the ineligible
13 part.

14 (3) The *reduced cost base of the ineligible part is that part of the
15 reduced cost base of the original interest as is reasonably
16 attributable to the ineligible part.

17 (4) For the purposes of sections 124-1235 and 124-1245, for each
18 original interest that has an ineligible part:

19 (a) reduce the *cost base of that interest (just before the *CGT
20 event that happened in relation to it) by so much of that cost
21 base as is attributable to that ineligible part; and

22 (b) reduce the *reduced cost base of that interest (just before the
23 CGT event that happened in relation to it) by so much of that
24 reduced cost base as is attributable to that ineligible part.

25 **124-1235 Roll-over consequences—all original interests were** 26 **post-CGT and pre-UCA**

27 (1) If you *acquire the new interest in exchange for:

28 (a) one original interest that you acquired on or after
29 20 September 1985 and before 1 July 2001; or

30 (b) 2 or more original interests, each of which you acquired on or
31 after 20 September 1985 and before 1 July 2001;

32 you are taken to have acquired the new interest (or all of the new
33 interests) before that day.

34 (2) The first element of the *cost base of the new interest (or of each of
35 the new interests) is such amount as is reasonable having regard to:

Comment [A10]: This section seems to be missing the asterisk (*) next to a number of defined terms.

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- 1 (a) the total of the cost bases of all the original interests; and
- 2 (b) the number, *market value and character of the original
- 3 interests; and
- 4 (c) the number, market value and character of the new interests.
- 5 (3) The first element of the *reduced cost base of the new interest (or
- 6 of each of the new interests) is such amount as is reasonable having
- 7 regard to:
- 8 (a) the total of the reduced cost bases of all the original interests;
- 9 and
- 10 (b) the number, *market value and character of the original
- 11 interests; and
- 12 (c) the number, market value and character of the new interests.

13 **124-1240 Roll-over consequences—all original interests were**
14 **pre-CGT**

- 15 If you *acquire the new interest in exchange for:
- 16 (a) one original interest that you acquired before 20 September
 - 17 1985; or
 - 18 (b) 2 or more original interests, each of which you acquired
 - 19 before 20 September 1985;
- 20 you are taken to have acquired the new interest (or all of the new
- 21 interests) before that day.

22 **124-1245 Roll-over consequences—original interests were of mixed**
23 **CGT status, all were pre-UCA**

- 24 (1) This section applies if:
- 25 (a) you *acquire the new interest in exchange for more than one
- 26 original interest; and
- 27 (b) you acquired one or more of the original interests before
- 28 20 September 1985; and
- 29 (c) you acquired one or more of the original interests on or after
- 30 that day; and
- 31 (d) you did not acquire any of the original interests on or after
- 32 1 July 2001.
- 33 (2) Each new interest is taken to be 2 separate *CGT assets that are
- 34 both new interests:

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- 1 (a) one (which you are taken to have *acquired on or after
2 20 September 1985) representing the extent to which you
3 acquired the original interests on or after that day; and
4 (b) another (which you are taken to have acquired before that
5 day) representing the extent to which you acquired the
6 original interests before that day.

- 7 (3) The first element of the *cost base and *reduced cost base of the
8 *CGT asset mentioned in paragraph (2)(a) in relation to a new
9 interest is worked out under the formula:

10
$$\text{Total post-CGT cost base} \times \frac{\text{Market value of new interest}}{\text{Market value of all new interests}}$$

11 where:

12 *market value of all new interests* is the total of the *market values
13 of all of the new interests.

14 *market value of new interest* is the *market value of the new
15 interest to which the *CGT asset mentioned in paragraph (2)(a)
16 relates.

17 *total post-CGT cost base* is the total of the *cost bases of all the
18 original interests that you *acquired on or after 20 September 1985.

19 **124-1250 Roll-over consequences—some original interests were** 20 **pre-UCA**

- 21 (1) This section applies if:
22 (a) you *acquire the new interest in exchange for more than one
23 original interest; and
24 (b) you acquired one or more of the original interests (*pre-UCA*
25 *interests*) before 1 July 2001; and
26 (c) you acquired one or more of the original interests (*post-UCA*
27 *interests*) on or after that day.
- 28 (2) If you *acquired all of the pre-UCA interests on or after
29 20 September 1985, each new interest is taken to be 2 separate
30 assets that are both new interests:
31 (a) one (which you are taken to have acquired on or after that
32 day and before 1 July 2001) representing the extent to which
33 the original interests are pre-UCA interests; and

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- 1 (b) another (which you are taken to have acquired on or after
2 1 July 2001) representing the extent to which the original
3 interests are post-UCA interests.
4 Apply section 124-1235 to the interest referred to in paragraph (a)
5 as if the pre-UCA interests were the only original interests. Apply
6 Division 40 to the interests referred to in paragraph (b).
- 7 (3) If you *acquired all of the pre-UCA interests before 20 September
8 1985, each new interest is taken to be 2 separate assets that are
9 both new interests:
10 (a) one (which you are taken to have acquired before that day)
11 representing the extent to which the original interests are
12 pre-UCA interests; and
13 (b) another (which you are taken to have acquired on or after
14 1 July 2001) representing the extent to which the original
15 interests are post-UCA interests.
16 Apply section 124-1240 to the new interest referred to in
17 paragraph (a) as if the pre-UCA interests were the only original
18 interests. Apply Division 40 to the new interest referred to in
19 paragraph (b).
- 20 (4) If you *acquired one or more of the pre-UCA interests before
21 20 September 1985 and one or more of the pre-UCA interests on or
22 after that day, each new interest is taken to be 3 separate assets that
23 are all new interests:
24 (a) one (which you are taken to have acquired on or after
25 20 September 1985 and before 1 July 2001) representing the
26 extent to which the original interests that you acquired on or
27 after 20 September 1985 are pre-UCA interests; and
28 (b) another (which you are taken to have acquired before
29 20 September 1985) representing the extent to which the
30 original interests that you acquired before 20 September 1985
31 are pre-UCA interests; and
32 (c) another (which you are taken to have acquired on or after
33 1 July 2001) representing the extent to which the original
34 interests are post-UCA interests.
35 Apply section 124-1245 to the new interests referred to in
36 paragraphs (a) and (b) as if the pre-UCA interests were the only
37 original interests. Apply Division 40 to the new interest referred to
38 in paragraph (c).
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1 **# Subsection 995-1(1)**

2 Insert:

3 *interest realignment adjustment* has the meaning given by
4 subsection 40-364(7).

5 *interest realignment arrangement* has the meaning given by
6 subsection 40-363(5).

7 ***Income Tax (Transitional Provisions) Act 1997***

8 **# After subsection 40-77(1C)**

9 Insert:

10 (1D) Division 40 of the new Act does not apply to an interest in a
11 mining, quarrying or prospecting right that you started to hold on
12 or after 1 July 2001 if:

- 13 (a) you acquired the interest under an interest realignment
14 arrangement; and
15 (b) the interest was acquired in exchange for one or more other
16 interests in other mining, quarrying or prospecting rights all
17 of which you had started to hold before 1 July 2001.

18 (1E) If:

- 19 (a) you acquired, under an interest realignment arrangement, an
20 interest (a *new interest*) in a mining, quarrying or prospecting
21 right; and
22 (b) the interest was acquired in exchange for one or more other
23 interests (*old interests*) in other mining, quarrying or
24 prospecting rights; and
25 (c) you started to hold some of the old interests before 1 July
26 2001;

27 Division 40 of the new Act applies to the new interest only to the
28 extent that the new interest was acquired in exchange for the old
29 interests that you started to hold on or after 1 July 2001.

30 **# Application**

31 The amendments made by this Part apply in relation to:

- 32 (a) mining, quarrying or prospecting rights that an entity starts
33 to hold after 7.30 pm, by legal time in the Australian Capital
34 Territory, on 14 May 2013; and

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- 1 (b) balancing adjustment events that happen after that time; and
- 2 (c) CGT events that happen after that time.

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1 **Part 2—Farm-in farm-out arrangements**

2 *Income Tax Assessment Act 1997*

3 **# Section 11-55 (after table item headed “environment”)**

4 Insert:

farm-in farm-out arrangements

rewards for providing exploration benefits 40-1120

5 **10 Section 40-175 (note)**

6 After:

- 7 • paragraph 40-365(5)(a);

8 insert:

- 9 • section 40-1110;

10 **# At the end of subsection 40-180(4)**

11 Add:

12 Note: The first element of cost may be reduced under section 40-1105 to
13 account for non-cash benefits received under farm-in farm-out
14 arrangements.

15 **# Subsection 40-300(3) (note)**

16 Repeal the note, substitute:

17 Note 1: Termination value may be adjusted under Subdivision 27-B so that
18 any GST consequences are accounted for.

19 Note 2: Termination value may be reduced under section 40-1105 to account
20 for non-cash benefits received under farm-in farm-out arrangements.

21 **# After Subdivision 40-J**

22 Insert:

1 **Subdivision 40-K—Farm-in farm-out arrangements**

2 **Guide to Subdivision 40-K**

3 **40-1100 What this Subdivision is about**

4 The costs and termination values of parts of interests in mining,
5 quarrying or prospecting rights that are transferred under farm-in
6 farm-out arrangements are reduced by the market value of the
7 exploration benefits conferred under the arrangements.

8 **Table of sections**

9 40-1105 Treatment of certain non-cash benefits under farm-in farm-out
10 arrangements
11 40-1110 Cost of split interests resulting from farm-in farm-out arrangements
12 40-1115 Deductions for certain expenditure covered by exploration benefits
13 40-1120 Rewards for providing exploration benefits
14 40-1125 Cost base and reduced cost base of exploration benefits etc.
15 40-1130 Effect of exploration benefits on the cost of mining, quarrying or
16 prospecting information
17 40-1135 Meaning of *farm-in farm-out arrangement* etc.

18 **Operative provisions**

19 **40-1105 Treatment of certain non-cash benefits under farm-in**
20 **farm-out arrangements**

- 21 (1) If, under a *farm-in farm-out arrangement, you receive an
22 *exploration benefit in relation to the transfer of part of your
23 interest in a *mining, quarrying or prospecting right, the
24 *termination value of the part of the interest is reduced by the
25 *market value of the exploration benefit.
- 26 (2) If, under a *farm-in farm-out arrangement, you provide an
27 *exploration benefit in relation to the transfer to you of part of
28 another entity's interest in a *mining, quarrying or prospecting
29 right, the first element of the *cost of the part of the interest is
30 reduced by the *market value of the exploration benefit.

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40-1110 Cost of split interests resulting from farm-in farm-out arrangements

Despite section 40-205, if:

- (a) under a *farm-in farm-out arrangement, you provide a part of your interest in a *mining, quarrying or prospecting right; and
- (b) because of subsection 40-115(2), this Division applies as if you had split your interest into the part you stopped holding and the rest of your interest;

then:

- (c) the first element of the cost of the asset that consists of the part you stopped holding is a reasonable proportion of the amount you are taken to have paid under section 40-185 for any economic benefit involved in splitting your interest; and
- (d) the first element of the cost of the asset that consists of the rest of your interest is the sum of:
 - (i) the *adjustable value of your interest just before it was split; and
 - (ii) a reasonable proportion of the amount you are taken to have paid under section 40-185 for any economic benefit involved in splitting your interest.

40-1115 Deductions relating to receipt of exploration benefits

(1) If:

- (a) under a *farm-in farm-out arrangement, you receive an *exploration benefit in exchange for providing a part of your interest in a *mining, quarrying or prospecting right; and
- (b) because of subsection 40-1105(1), the *termination value of the interest you provide is reduced;

your entitlement (if any) to a deduction under a provision of this Act, in relation to your expenditure consisting of the provision of that part, is reduced to the same extent as the reduction in the termination value.

(2) If the termination value is reduced to nil under subsection 40-1105(1), you are not entitled to a deduction under a provision of this Act in relation to your expenditure consisting of the provision of that part.

(3) If:

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- 1 (a) under a *farm-in farm-out arrangement, you receive an
2 *exploration benefit in exchange for providing a part of your
3 interest in a *mining, quarrying or prospecting right; and
4 (b) because of subsection 40-1105(1), the *termination value of
5 the interest you provide is reduced; and
6 (c) the exploration benefit consists of another party to the
7 arrangement funding on your behalf, or undertaking to fund
8 on your behalf, expenditure that you incur in relation to
9 exploration or prospecting by another entity;

10 your entitlement (if any) to a deduction under a provision of this
11 Act in relation to that expenditure is reduced to the same extent as
12 the reduction in the termination value.

- 13 (4) If the termination value is reduced to nil under
14 subsection 40-1105(1), you are not entitled to a deduction under a
15 provision of this Act in relation to that expenditure.

16 **40-1120 Rewards for providing exploration benefits**

17 (1) If:

- 18 (a) under a *farm-in farm-out arrangement, you provide
19 an *exploration benefit in exchange for you receiving under
20 the arrangement an interest in a *mining, quarrying or
21 prospecting right; and
22 (b) the interest that you receive is a part of another entity's
23 interest in a mining, quarrying or prospecting right; and
24 (c) because of subsection 40-1105(2), the first element of the
25 *cost of the part of the interest you receive is reduced; and
26 (d) for providing the non-cash benefit, you receive a reward as a
27 result of which an amount would, apart from this section, be
28 included in your assessable income;

29 to the extent of the reduction in the first element of the cost, the
30 amount is not assessable income and is not *exempt income.

- 31 (2) If the first element of the *cost is reduced to nil under
32 subsection 40-1105(2), the entire amount is not assessable income
33 and is not *exempt income.

34 **40-1125 Cost base and reduced cost base of exploration benefits etc.**

35 If:

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- 1 (a) under a *farm-in farm-out arrangement, you receive an
2 *exploration benefit; and
3 (b) the benefit involves one or more undertakings of the kinds
4 referred to in subparagraphs 40-1135(2)(a)(ii) and (iv);
5 the first element of the *cost base and the *reduced cost base of the
6 benefit are reduced by the *market value of the undertakings.

7 **40-1130 Effect of exploration benefits on the cost of mining, 8 quarrying or prospecting information**

9 If:

- 10 (a) you *hold a *depreciating asset that is *mining, quarrying or
11 prospecting information; and
12 (b) under a *farm-in farm-out arrangement, you receive an
13 *exploration benefit; and
14 (c) an amount or expenditure would, apart from this section, be
15 included in the second element of the *cost of the asset;
16 do not include that amount or expenditure in the second element to
17 the extent (if any) that it is reasonably attributable to the
18 exploration benefit.

19 **40-1135 Meaning of farm-in farm-out arrangement etc.**

20 (1) A *farm-in farm-out arrangement* is an *arrangement under which:

- 21 (a) an entity (the *transferor*) transfers, or agrees to transfer, part
22 of the entity's interest in a *mining, quarrying or prospecting
23 right to another entity (the *transferee*); and
24 (b) in exchange for the transfer, the transferee provides to the
25 transferor one or more *exploration benefits.

26 (2) The transferee provides an *exploration benefit* to the transferor if:

- 27 (a) the transferee:
28 (i) conducts *exploration or prospecting for *minerals, or
29 quarry materials, obtainable by *mining and quarrying
30 operations; or
31 (ii) undertakes to conduct exploration or prospecting for
32 *minerals, or quarry materials, obtainable by *mining
33 and quarrying operations; or
34 (iii) funds, on the transferor's behalf, expenditure that the
35 transferor incurs in relation to exploration or
36 prospecting ~~by another entity~~; and

Comment [A11]: It should be clarified that the consideration in respect of a farm-in farm-out arrangement does not need to be exclusively an exploration benefit; for example, a farm-in farm-out arrangement includes one where part of the consideration includes a cash amount.

Comment [A12]: As drafted, this would not include the funding of cash calls due by the transferor in respect of joint venture expenditure carried out by the Operator on behalf of the transferor, as this expenditure is incurred by the transferor via the agency of the Operator under the joint venture agreement

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- 1 (iv) undertakes to fund, on the transferor’s behalf,
2 expenditure that the transferor incurs in relation to
3 exploration or prospecting ~~by another entity~~; and
4 (b) the exploration or prospecting relates to the part of the
5 transferor’s interest in the mining, quarrying or prospecting
6 right that the transferors does not transfer, or agree to
7 transfer, under the arrangement; and
8 (c) were the transferor to conduct the exploration or prospecting,
9 amounts paid by the transferor relating to the exploration or
10 prospecting would:
11 (i) be included in the *cost of *mining, quarrying or
12 prospecting information *held by the transferor; or
13 (ii) be included in any other *depreciating asset, held by the
14 transferor, for which the decline in value is provided
15 under section 40-80; or
16 (ii) be deductible under section 40-730 or section 8-1.

Comment [A13]: See comment above.

17 **# At the end of subsection 104-35(5)**

18 Add:

- 19 ; or (g) you created the right by creating in another entity a right to
20 receive an *exploration benefit under a *farm-in farm-out
21 arrangement.

22 **# Section 112-97 (before table item 1)**

23 Insert:

1A	You receive, under a farm-in farm-out arrangement, an exploration benefit or an entitlement to an exploration benefit	First element of cost base and reduced cost base	Section 40-1125
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24 **# Section 116-25 (cell at table item A1, column headed**
25 **“Special rules:”)**

26 Repeal the cell, substitute:

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If the *disposal is because another entity exercises an option: see section 116-65

If the disposal is of *shares or an interest in a trust: see section 116-80

If the disposal is a gift for which a section 30-212 valuation is obtained: see section 116-100

If a roll-over under Subdivision 310-D applies: see section 116-110

If the disposal is a disposal of part of an interest in a *mining, quarrying or prospecting right under a *farm-in farm-out arrangement: see section 116-115

1

2 **# Section 116-25 (cell at table item C2, column headed**
3 **“Special rules:”)**

4 Omit “and 116-10”, substitute “, 116-110 and 116-115”.

5 **# At the end of Division 116**

6 Add:

7 **116-115 Farm-in farm-out arrangements**

8 (1) If:

9 (a) CGT event A1 is the disposal of part of your interest in a
10 *mining, quarrying or prospecting right; and

11 (b) the interest is disposed of under a *farm-in farm-out
12 arrangement; and

13 (c) you have received an *exploration benefit in respect of the
14 event happening;

15 in working out the *capital proceeds for the *CGT event, treat as
16 zero the *market value of the exploration benefit.

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- 1 (2) If:
2 (a) CGT event C2 arises as a result of an *exploration benefit
3 being provided to you; and
4 (b) the exploration benefit is provided under a *farm-in farm-out
5 arrangement;
6 in working out the *capital proceeds for the *CGT event, treat as
7 zero the *market value of the exploration benefit.

8 **# After subsection 230-460(17)**

9 Insert:

10 *Exploration benefits*

- 11 (17A) A right or obligation that arises because of the provision of an
12 *exploration benefit under a *farm-in farm-out arrangement is the
13 subject of an exception.

14 **# Subsection 995-1(1)**

15 Insert:

16 *exploration benefit* has the meaning given by
17 subsection 40-1135(2).

18 *farm-in farm-out arrangement* has the meaning given by
19 subsection 40-1135(1).

20 **# Application**

21 The amendments made by this Part apply in relation to farm-in farm-out
22 arrangements entered into after 7.30 pm, by legal time in the Australian
23 Capital Territory, on 14 May 2013.