Towards a Competitive Mining Taxation System

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The Australian resources industry has historically been one of Australia's largest revenue earners and will maintain this position well into the future. The industry forms a vital part of the overall Australian economy. Accordingly, it is essential for Australia to have a resources industry that is able to actively compete in the international marketplace. In this regard it must also be realised that the companies looking to invest capital in the mining industry possess a global outlook. Any proposed investment in Australia will be compared with investment opportunities in other Pacific rim countries with strong resources industries such as Chile, Malaysia, Papua New Guinea and the Philippines.

There are numerous factors which contribute to determine the worldwide competitiveness of the Australian resources industry. One such factor is the Australian taxation system as it applies to mining companies, which is particularly important given that many of the Australian mining industry's Pacific rim competitors offer significant taxation concessions to encourage the establishment of mining operations.

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It is well established that three broad principles are necessary to ensure a taxation system is effective and competitive. These principles are as follows:

(a) equality;

(b) certainty; and

(c) simplicity.

It is considered that the Australian taxation system as it applies to mining companies is lacking in regard to each of these three principles. Accordingly, the objective of this paper is to highlight some of the major areas of the Australian income tax system which are leading to inequities, uncertainties and unnecessary complexities for Australian mining companies when compared with their international competitors.

In order to highlight these areas it will also be necessary to review the historical background and intention of the specific mining provisions of the *Income Tax Assessment Act* 1936 (Cth) ("the Act") and the current framework of the self-assessment system of company taxation. In addition it is also intended to comment upon some perceived difficulties with the approach presently adopted by the Australian Taxation Office ("ATO") towards mining companies.

In so doing, this paper seeks to both provide a stimulus and form a framework that will enable the mining industry, through AMPLA and other industry bodies, to lobby the government towards making the necessary legislative changes that will ensure the Australian mining taxation system is competitive on a worldwide basis.

HISTORICAL BACKGROUND TO MINING PROVISIONS

Traditionally, the Australian income tax regime has recognised that the mining and petroleum industries need specific taxation concessions to compensate for the high level of capital expenditures that are required in these industries and the often limited life span of the assets generated by those capital expenditures. In recent times these taxation concessions have been contained in the following provisions of the Act:

(a) Div 10 of the Act which provides tax relief for certain capital expenditure incurred by mining and quarrying companies both in mine development and exploration;

(b) Div 10AAA of the Act which provides tax relief for certain capital expenditure incurred by mining and quarrying companies on minerals transport facilities;

(c) Div 10AA of the Act which provides tax relief for certain expenditures incurred by petroleum mining companies;

(d) Div 10AB of the Act which applies to expenditure incurred after 30 June 1991 on the rehabilitation and restoration of mining, quarrying and petroleum sites; and

(e) the exemption provided under s 23(pa) of the Act for income derived by a bona fide prospector on the sale of a mining right.

The history of the present mining provisions and the rationale behind their introduction are perhaps best summarised by the comments made by the then Treasurer, Mr McMahon, to the Parliament in the Second Reading Speech to the Bill which introduced the present Div 10. Mr McMahon said:

> " . . . the major part of the Bill before the House comprises amended special provisions for deductions in respect of capital expenditure that mining enterprises can make in arriving at their taxable income . . . From the inception of Commonwealth income taxation, special provision has been made for such deductions. The provisions were last subject to major review following the Report of the Commonwealth Committee on Taxation, 1950-54. Some time ago several companies put to the government the view that the existing provisions did not adequately recognise some large capital expenditures necessarily incurred in major new ventures undertaken by mining enterprises. They also informed the government that legal advice obtained by the companies questioned the interpretation of some of these provisions by the Commissioner of Taxation.
>
> On examination, the government came to the view that it would not be desirable to attempt further piecemeal amendment of existing provisions which have been added to and amended many times. Further, the provisions are expressed in general terms; for the most part they do not state with any precision which capital expenditures are within their scope and which are not. It was therefore decided to undertake a thorough review of the relevant provisions of the law. The Bill before the House reflects the results of that review. It aims to clarify and rationalise the law in the light of the changed circumstances of present day large scale mining developments. Rather than leave the treatment of particular kinds of expenditure to be determined according to whether, on the facts of particular situations, they fall within provisions expressed in a general way, the Bill describes the major classes of expenditure for which special deductions may or may not be made.
>
> . . . [I]t has long been accepted that the special circumstances of the mining industry, including the wasting nature of ore deposits and the unusual need often faced by mining companies to provide transport and community facilities, should be appropriately recognised through special provisions in the taxation law. The need for this recognition is of particular importance in the case of the Australian economy because of the growing contribution the mining industry is making to export earnings and to the development of remote areas of the country."[1]

It is perhaps unfortunate that since 1968, the law has been constantly added to and amended in a piecemeal fashion. It is intended in this paper to demonstrate that the uncertainties that this legislation is now creating means that another full review of the mining provisions is necessary. In addition, the situation has arisen again where the existing

1. W McMahon, Second Reading Speech to Income Tax Assessment Bill (No 2) 1968.

provisions do "not adequately recognise some large capital expenditures necessarily incurred in major new ventures"[2] and "do not represent the changed circumstances of present-day large scale mining development".[3]

CURRENT TAXATION REGIME

The Australian taxation regime has become increasingly complex over the last ten years. The introduction of new areas such as capital gains tax, fringe benefits tax, and the complicated rules relating to foreign-sourced income has meant that there is an increasing compliance burden on mining and petroleum companies. It is suggested that the ever-increasing costs of complying with the current taxation regime have a detrimental effect on the ability of the Australian mining industry to compete in the world marketplace.

It is also necessary to consider the implications of the introduction of the self-assessment system and the effect that this has had on the burden for mining and petroleum companies. As the majority are aware, a self-assessment system of income tax was introduced initially in 1986 and gradually expanded until a *full* self-assessment system was introduced for companies in the 1990 year of income.

Under the full self-assessment system a company is required to lodge a simple return form which is deemed to be the company's notice of assessment. Although the ATO does not generally undertake a detailed examination of an income tax return on lodgment, all mining and petroleum companies are required to retain all the records relating to the calculation of their taxable income. The ATO has the power to carry out a full and detailed audit of the taxpayer's affairs to ensure that the calculation of taxable income is correct and that all taxation legislation has been fully complied with.

A number of further self-assessment system initiatives were introduced in the 1993 income year by the *Taxation Laws Amendment (Self Assessment) Act* 1992 (Cth). The initiatives that were introduced by this Act are summarised below:

(a) a new system of binding public and private rulings. Applications for review of private rulings may be made to the Administrative Appeals Tribunal or the Federal Court;

(b) an extension of the time period within which a taxpayer can object against assessments, from 60 days to four years;

(c) provisions to allow the Commissioner, in making assessments, to rely on statements made by taxpayers other than in tax returns;

(d) the introduction of a new system of penalties for understatements of income tax, based on a standard of the taxpayer having a "reasonably arguable position" and providing greater certainty as to penalties that may be incurred;

2. Ibid.
3. Ibid.

(e) a new interest system for underpayments and late payments; and

(f) the removal, in most cases, of the requirement for taxpayers to lodge elections or other notices.

One result of the self-assessment system of income tax is that companies often have to determine the correct income tax treatment for a particular item and this may require an analysis of a particularly complex area of taxation law. In placing the responsibility of the determination of the treatment of a particular item on the taxpayer, it is a logical requirement for the taxation legislation to be clear and concise. Whilst, as noted above, the self-assessment system allows the taxpayer to seek a binding ruling from the ATO, in a circumstance where the treatment of a particular item is in doubt, it is suggested that it is not acceptable to require a company to seek a ruling every time a routine transaction is contemplated. In any event, as has been demonstrated in the recent cases of *CTC Resources NL v FCT*[4] and *Payne v FCT*,[5] the use of the private ruling system may be an expensive, time-consuming and perhaps fruitless exercise for taxpayers.

LEGISLATIVE UNCERTAINTIES AND INEQUITIES

As noted previously, the current Div 10 of the Act was introduced with the purpose of removing legislative uncertainties relating to mining expenditure. As Mr McMahon stated: "Indeed the government has been concerned to remove uncertainties on the part of mining enterprises as to their tax position in respect of future capital expenditures."[6] However, many uncertainties remain in the application of the mining provisions to everyday transactions.

In the following paragraphs, I have set out a commentary of some current uncertainties and inequities which mining companies are faced with. The areas dealt with are as follows and are not necessarily in order of importance:

(a) **Problems arising on disposal of a mining tenement**

- Allowed or allowable;
- Disposal of mining information
  - —Analysis of Div 10 uncertainties;
  - —Analysis of Capital Gains Tax (CGT) uncertainties;
- Treatment of farm-outs.

(b) **Capital expenditure non-deductibility**

- Demolition expenditure;
- Public road expenditure;
- Compensation payments to landowners;
- Mabo[7] and other access payments.

4. 93 ATC 4072.
5. 94 ATC 4191.
6. Above, n 1.
7. *Mabo v Queensland (No 2)* (1992) 175 CLR 1.

Problems arising on disposal of a mining tenement

"Allowed and allowable"

It is not an uncommon transaction for a mining company to dispose of an interest in a mining tenement and for s 122K of the Act to be triggered. In such a case, an amount will be either included in assessable income or allowed as a deduction in respect of property in respect of which deductions have been claimed under either s 122DG or 122J of the Act. As each of the relevant provisions of the Act has existed largely unchanged for some time it would seem reasonable to assume that the treatment of this everyday transaction would be clear. However, this is not the case and the following example is provided to demonstrate the inconsistency.

A mining company incurs allowable capital expenditure of $200,000 in the 1992 year of income and is allowed deductions of $20,000 in each of the 1992 and 1993 years of income, pursuant to s 122DG of the Act. However, as the mining company is in a tax loss position for each of these years and no election is made under s 122DG(6A) of the Act, the $40,000 is carried forward under s 122DG(7) of the Act. The mining company disposes of the relevant property in the 1994 year of income for consideration of $180,000. As a result s 122K of the Act is triggered, which provides:

> "Where the aggregate of—
>
> (a) the sum of the deductions so allowed or allowable; and
>
> (b) the consideration receivable in respect of the disposal, loss or destruction or, in the case of other termination of the use of property, the value of the property at the date of termination of use,
>
> exceeds the total expenditure of a capital nature of the taxpayer in respect of that property, so much of the amount of the excess as does not exceed the sum of those deductions shall be included in the assessable income."[8]

Accordingly, the application of s 122K(2) of the Act depends upon whether the $40,000 of deductions carried forward under s 122DG(7) of the Act are in fact "allowed or allowable". Generally, it is accepted that in this situation the term "allowed or allowable" does not include amounts carried forward under s 122DG(7) of the Act. This results in s 122K of the Act applying as follows:

	$
Deductions "allowed or allowable"	Nil
Add: consideration receivable	180,000
	180,000
Less: expenditure	200,000
Amount deductible	$20,000

8. s 122K(2).

As s 122DG(8) of the Act applies to deny any future deduction for the $40,000 of unrecouped deductions carried forward, the result of $20,000 as a deduction is a logical solution which is fair for both the Revenue and the taxpayer.

If we now assume that the $200,000 incurred was exploration expenditure deductible under s 122J of the Act with no election being made under s 122J(4BA) of the Act, $200,000 would be carried forward under s 122J(4C) of the Act.

Further, if we assume, as in the above example, that the deductions carried forward under s 122J(4C) of the Act are not "allowed or allowable", then the amount deductible by reference to s 122K(2) of the Act would be $20,000. Unfortunately, in this case the interpretation does not provide a logical answer, as s 122J of the Act has no provision equivalent to s 122DG(8) of the Act that operates to remove the taxpayer's entitlement to claim the unrecouped deduction in the future. Accordingly, in this case the mining company would be able to claim the $200,000 as a s 122J deduction if it derives sufficient assessable income in a future income year as well as the deduction under s 122K(2).

I am aware that in attempting to make sense of this inconsistency, the ATO have taken the approach that there is a different meaning of "allowed and allowable" for the purposes of s 122J(4C) of the Act.

In the case mentioned above, the $200,000 carried forward would be considered to be "allowed or allowable" and the s 122K(2) amount would be calculated as follows:

	$
Deductions "allowed or allowable"	200,000
Add: consideration receivable	180,000
	20,000
Less: expenditure	200,000
Amount assessable	$180,000

The effect of this approach is to include $180,000 in assessable income whilst receiving an allowable deduction for $200,000. The net result being the same as if the legislative problems were properly rectified.

The meaning of "allowed or allowable" was further confused when s 122JAA of the Act was introduced to apply to disposals of property after 19 December 1991. This provision was introduced with the intention of allowing the entitlement to Div 10 deductions to be transferred when a capital gains tax rollover is applicable or parties to a change in part-ownership of a property owned by multiple parties elect to rollover under s 122R of the Act. In broad terms, the intention of the rollover is to enable the purchaser to inherit the vendor's basis of claiming deductions. This is demonstrated by the summary of the consequences of balancing adjustment rollover relief contained in the explanatory memorandum which accompanied the Act introducing s 122JAA:

> "The transferee will be taken to have acquired the property for an amount equal to the transferor's undeducted allowable capital expenditure in respect of the property at the time of disposal, irrespective of the actual consideration paid. The characteristics of this undeducted allowable capital expenditure will pass to the transferee . . . [And further,] the transferee will stand in the place of the transferor as regards any excess (exploration or allowable capital expenditure) amount in respect of the property at the time of the disposal."[9]

It is clear from the wording of s 122JAA(4) and (5) of the Act that the intention of the section is to enable unrecouped deductions carried forward under s 122DG(7) of the Act to be transferred. However, pursuant to s 122JAA(1)(b) of the Act, the provisions of s 122JAA only apply if deductions have been "allowed or allowable" to the transferor. As noted above, the application of s 122K of the Act provides considerable support for the fact that amounts carried forward under s 122DG(7) of the Act are not "allowed or allowable". However, this interpretation is contrary to the clear intention of s 122JAA of the Act.

I am aware that in attempting to overcome this s 122JAA problem, the ATO appears to have taken the approach that "allowed or allowable" can have different meanings depending on the context. This approach has cleared up the uncertainty to some extent, however, the inconsistency remains in the legislation and should be removed to enable mining companies to plan their transactions with certainty as to their taxation implications.

Disposal of mining information

When mining companies dispose of an interest in a tenement the information relevant to the tenement is usually disposed of at the same time and often a material component of the consideration is allocated to that mining information. However, the question of whether the information is an asset for capital gains tax purposes and whether it is property for the purposes of s 122K of the Act is a major area of legislative uncertainty. This needs to be considered in further detail.

Both ss 122K and 122JAA of the Act apply where there is a "disposal of property"[10] and where deductions have been allowed or allowable "in respect of expenditure of a capital nature in respect of the property"[11] in the case of s 122K of the Act and "in respect of property"[12] in the case of s 122JAA of the Act. Hence, a prerequisite for both sections to apply is that there is *a disposal of property*. It also follows from an analysis of s 122JAA of the Act that such a disposal must also be a disposal of an asset for CGT purposes to enable the balancing charge rollover relief to be obtained. If mining information is not an asset for CGT purposes and it is not property it follows that ss 122K

9. Explanatory Memorandum to *Taxation Laws Amendment Act* 1992 (Cth).
10. s 122K(1); s 122JAA(1).
11. s 122K(1).
12. s 122JAA(1).

and 122JAA of the Act would have no application. Accordingly, it is a fundamental issue whether mining information is property and hence an asset for CGT purposes.

Division 10 uncertainties—s 122K

Before examining the related question of whether information is an asset for capital gains tax purposes, it is worth considering the operation of s 122K of the Act in the context of both the disposal of a mining tenement (together with mining information) and the relinquishment of a right to explore where there is no related disposal of mining information.

Disposal of information Where mining information is sold together with the rights to explore or mine the area of interest to which it relates and a taxpayer has incurred capital expenditure to accumulate that information, it is arguable that the expenditure in accumulating the mining information should be regarded as expenditure in respect of property for the purposes of s 122K of the Act. In these circumstances and subject to the amount of consideration received the disposal may give rise to an allowable deduction or cause an amount to be included in assessable income in accordance with the provisions of s 122K of the Act. This view appears to be consistent with that adopted in Income Tax Ruling IT 2378 in which the Commissioner sets out his views on the application of the CGT provisions to "farm-out" arrangements. (See below, p 518, for further discussion on farm-outs.)

In the preamble to Income Tax Ruling IT 2378 the Commissioner states:

> "For the purposes of the application of the income tax balancing adjustment provisions, a disposal of an interest in a prospecting right under a farm-out arrangement for a commitment to undertake exploration expenditure without any further consideration is a disposal of property otherwise than by sale. In such circumstances, paras 122K(4)(c) and 124AM(7)(c) would have the effect that the consideration for the disposal is the value, if any, of the property at the date of disposal."[13]

It would seem from this statement that the Commissioner would expect a balancing charge to arise where exploration expenditure had been incurred. The link between exploration expenditure and the property was also commented on by the Commissioner in one of the examples in the ruling dealing with the disposal of an interest in a tenement for $500,000:

> "Under the first option Spec Co could be entitled to an income tax deduction for, and to include in its CGT cost base, expenditure on drilling equal to $522,500 (55 per cent of 950,000), which could largely be met out of the $500,000 cash proceeds, to offset any balancing adjustment and real capital gain."[14]

13. Income Tax Ruling IT 2378, para 7.
14. Ibid, para 24.

It is submitted that these comments suggest that the Commissioner's view is that s 122K of the Act will automatically apply where there is a disposal of a tenement and that exploration expenditure forms part of the cost base of a tenement. The point on cost base is consistent with the view expressed in a press release made by the Treasurer which refers to mining information as an asset:

> "Assets corresponding to capital expenditures undertaken under the authority of a mining right and which attract income tax deductions together with balancing adjustments on disposal will, as under current income tax law and general CGT arrangements, be treated as separate assets for CGT purposes. The balancing adjustment provisions allow nominal capital losses for income tax purposes and preclude the need for nominal CGT losses to be allowed in respect of those assets. The operation of these provisions requires separation of the value of those assets embodied in the overall consideration for the mining right." [15]

It is submitted that the comments in Income Tax Ruling IT 2378 point to the view that exploration expenditure forms part of the cost base of the tenement or exploration right as it is incurred for "the purpose of enhancing the value of the asset and is reflected in the state and nature of the asset at the time of disposal of the asset" [16] rather than being the cost of information which is to be regarded as a separate asset. In a practical sense, the conclusion that exploration expenditure forms part of the cost base of the tenement or right reflects the commercial reality, as it seems unlikely that the information would be sold separately from the right itself. Nevertheless, it is acknowledged that exploration can occur without the ownership of the property explored, for example, using aerial surveys. Clearly, this expenditure could not be reflected in the state and nature of any asset. On the other hand given that the information is available to anyone who wishes to utilise this type of exploration technique, the information may not have any particular value. The fact that such exploration costs are not adequately dealt with by existing legislation is further evidence that the law in this area is unsatisfactory.

Where a taxpayer has claimed a deduction for exploration expenditure, that expenditure cannot be transferred to the purchaser by way of a s 122B notice unless an amount is included in the assessable income of the vendor in accordance with s 122K of the Act. In the context of a transfer of an interest in a mining right together with mining information the position adopted by the Commissioner and confirmed in the May 1986 press release would seem to enable the provisions of Div 10 of the Act to operate in accordance with their legislative intent.

Relinquishment of rights Where a taxpayer merely relinquishes its rights to explore (that is they revert back to the relevant State) the question which arises is whether the expression "expenditure of a

15. P Keating, "Press Release", 22 May 1986.
16. s 160ZH(1)(c).

capital nature (incurred) by the taxpayer in respect of property''[17] includes:

(i) both the right to explore and the related mining information; or

(ii) separately the right to explore and the related mining information.

Where the property includes both the exploration right and related information it would follow from the Commissioner's interpretation in Income Tax Ruling IT 2378 that where a taxpayer disposes of the right to explore together with the related information for no consideration, s 122K of the Act would apply at that time to give the taxpayer a balancing charge deduction. In these circumstances, deductions would be carried forward through the loss provisions of ss 79E and 80 of the Act rather than through the operation of s 122J of the Act. In addition, if this view is correct s 122K or 122JAA of the Act would not apply to any future transfer between wholly-owned group companies as the expenditure is not carried forward under s 122J of the Act so that s 122JAA of the Act is not relevant. In addition, it is possible that s 122K of the Act would not apply in relation to a subsequent transfer to recoup deductions and as such it would not be possible for a s 122B notice to be agreed by the purchaser and the vendor.

Where the property is treated separately as the right to explore and the related information it would seem that the only disposal occurring on relinquishment of the right to explore would be a disposal of the right itself. Therefore, s 122K of the Act would operate only with respect to expenditure incurred on the acquisition of the right. On this basis, the mining information would not be regarded as being disposed of until it was physically disposed of by way of destruction of records or information. Until such a disposal has occurred no s 122K event would arise.

It is submitted that for this reason, the Commissioner has in the past allowed exploration companies to carry forward exploration expenditure in accordance with s 122J of the Act even though the tenements to which the exploration relates are no longer owned by the taxpayer. It would therefore be consistent with this treatment by the Commissioner for a taxpayer who has exploration expenditure carried forward to be able to transfer that expenditure under a s 122B notice. In these circumstances, to the extent that the information is not destroyed, s 122K of the Act should only apply where a taxpayer no longer satisfies s 122J(4D) of the Act, that is, the taxpayer no longer carries on or proposes to carry on prescribed mining operations or a business of exploring or prospecting for minerals obtainable by such operations.

Conclusion on s 122K As noted above, s 122JAA of the Act was introduced to enable the rollover of Div 10 deductions. The consequences of adopting a narrow interpretation of the meaning of property could be to restrict the application of that section to such an extent that it has no operating power. My view is that the analysis of s 122K above demonstrates inconsistencies in the legislation which

17. s 122K(1).

must be addressed. Mining companies must be in a position of reasonable certainty particularly in the case of transactions as fundamental as the disposal of tenements.

CGT uncertainties

Definition of asset The leading Australian case dealing specifically with the issue of whether information is property is *Pancontinental Mining Ltd v Commissioner of Stamp Duties (Qld)*.[18] In that case, Pancontinental Mining Ltd ("Pancontinental") purchased Mount Isa Mines Ltd's interests in the Lady Loretta Joint Venture. Included in the purchase price was an amount of approximately $4.45 million which was considered to be mining information arising from work undertaken by the joint venturers. The Queensland Commissioner of Stamp Duties assessed the whole of the consideration under the agreement, being a transfer of property under the relevant provisions of the *Stamp Act* 1894 (Qld). Pancontinental contended that no duty was chargeable on the consideration applicable to the confidential information on the basis that it was not property.

In delivering the decision of the Full Supreme Court of Queensland de Jersey J agreed with Pancontinental's views:

> "In my opinion that contention is correct. There is no definition of 'property' in the Act, but the ordinary meaning of the word does not encompass information. There is plenty of support for that view in the authorities."[19]

The judge went on to quote from a number of cases which supported the conclusion of the court. In view of the limited reasons given in the decision it is suggested that the court considered that there was no doubt that information was not property in the context of the stamp duty law. However, as discussed later, this may not necessarily be the case in the context of CGT.

The decision in *Pancontinental Mining Ltd* was confirmed by the Supreme Court of Western Australia in *Nischu Pty Ltd v Commissioner of State Taxation (WA)*.[20] In that case, the court stated that "whatever light the mining information may throw on the value of the tenements to which it relates, the information itself does not form part of the tenements. The information, in my opinion, is neither 'land' nor 'property'."[21] This decision was confirmed on appeal by the Full Supreme Court of Western Australia in *Commissioner of State Taxation (WA) v Nischu Pty Ltd*.[22]

Whether this decision was relevant to the CGT provisions of the Act depends on the meaning of the term asset, which is defined in s 160A of the Act as follows:

18. 88 ATC 4190.
19. Ibid at 4191.
20. 90 ATC 4391.
21. Ibid at 4395.
22. 91 ATC 4371.

"In this part, unless the contrary intention appears, 'asset' means any form of property and includes:

(a) any of the following:

(i) an option;

(ii) a debt;

(iii) a chose in action;

(iv) any other right;

whether legal or equitable and whether or not a form of property;

(b) goodwill or any other form of incorporeal property;

(c) currency of a foreign country;

(d) (Omitted by No 191 of 1992);

(e) a taxpayer's interest in a partnership asset of a partnership in which the taxpayer is a partner; and

(f) so much of a taxpayer's interest in a partnership as is not covered by paragraph (d);

but does not include a motor vehicle of a kind covered by paragraph 82AF(2)(a) or an interest in such a motor vehicle."[23]

The definition of asset was recently amended by the *Taxation Laws Amendment Act (No 4)* 1992 (Cth) following the *Hepples*[24] and *Cooling*[25] cases but still does not specifically include confidential information. Therefore if confidential information is to be an "asset" it must come within one or more of the following categories:

(a) any form of property;

(b) any other right (whether or not a form of property); and

(c) any other form of incorporeal property.

It is submitted that, notwithstanding the lack of a defined category, there is some judicial support for the view that information is an asset under the existing definition.

The first comprehensive analyses of the capital gains provisions by the courts are contained in the judgments of the Full Federal Court in *Hepples v FCT*[26] and *FCT v Cooling*.[27] In addition, the definition of "asset" was referred to in the High Court in the appeal in *Hepples v FCT*.[28] In this paper I consider some comments of the judges in both the Federal Court and High Court decisions in the *Hepples* case.

In the Full Federal Court decision in *Hepples* case, all three judges considered the previous definition of asset in s 160A of the Act but did not make specific reference to confidential information in their discussion of that section. However, it seems reasonable to conclude

23. s 160A(1).
24. 90 ATC 4472.
25. 90 ATC 4808.
26. 90 ATC 4497.
27. 90 ATC 4472.
28. 91 ATC 4808.

that the collective view of the term asset was that it encompasses rights which are proprietary in nature but does not include personal rights such as the right to work. Nevertheless, Lockhart and Gummow JJ in deciding that the asset in question did not have to be the asset of a taxpayer concluded that the goodwill, trade secrets and trade connections of Hunter Douglas were assets of a proprietary character and were therefore assets within the meaning of the definition in s 160A.

In particular, the following statements indicate the views of the two judges:

Lockhart J:

> "The asset of which s 160M(7)(a) speaks (that is, the asset in relation to which the relevant asset or transaction is said to have taken place) consists of the trade secrets and trade connections and the goodwill attaching to the business of Hunter Douglas."[29]

Gummow J:

> "In *Smith Kline & French Laboratories (Australia) Ltd v Secretary to the Department of Community Services & Health* (16 May 1990, unreported), I concluded that the degree of legal protection afforded by the legal system (especially in equity) to confidential information (and this would be true particularly of trade secrets) makes it appropriate to describe such confidential information as having a proprietary character, not because this is the basis on which that information is given, but because this is the effect of that protection. I do not repeat the reasons for that conclusion."[30]

and further:

> "Further, as I have indicated, the goodwill, trade secrets and trade connections of Hunter Douglas were of a proprietary character and therefore 'assets' within the meaning of the definition in s 160A."[31]

In the views expressed by Gummow J it is clear that he considers confidential information to be an asset for capital gains purposes. However, the issues in *Hepples* case have been dealt with by the High Court and accordingly, it is necessary to examine the judgments of the High Court.

The definition of an asset was also addressed by the Full Bench of the High Court and the question of whether a trade secret or confidential information is an asset for capital gains purposes was addressed by a number of the judges. The judges' discussions on this issue included the following:

Brennan J:

> "A majority of the Federal Court identified the trade secrets, trade connection and goodwill of Hunter Douglas as assets falling within para (a) of subs (7). The question then arose as to whether the asset

29. 90 ATC 4497 at 4508.
30. Ibid at 4520.
31. Ibid at 4521.

referred to in para (a) had to be an asset of the taxpayer. The majority gave a negative answer to this question. I forbear from answering the same question because, in my respectful opinion, there was no connection between the assets of Hunter Douglas and the appellant's entry into the deed containing the covenant which satisfies the requirements of para (a). The only way in which the appellant's covenant affected these Hunter Douglas assets was to add to them the benefit of the appellant's covenant."[32]

Dawson J:

"The covenants in question in this case all went to protect Hunter Douglas's business against competition by the appellant and the entry by the appellant into those covenants was an act or transaction which took place in relation to Hunter Douglas's goodwill. It was an act or transaction which enhanced Hunter Douglas's goodwill and it was, therefore, also an event affecting Hunter Douglas's goodwill. The trade secrets and the special processes may also have constituted knowledge with a value apart from goodwill and therefore might be regarded as assets separate from Hunter Douglas's goodwill, but the covenants not to divulge or use them undoubtedly protected Hunter Douglas against competition and in so doing assisted in generating goodwill. I do not think that it can be doubted that a covenant in restraint of trade may enhance the value of the goodwill of a business."[33]

Toohey J:

"What, in the present case, is the asset to which para (a) refers? It may or may not be the case that Hunter Douglas's rights under the deed constituted an asset for the purpose of Pt IIIA; that is a matter adverted to later in these reasons. But in the respondent's submission it was, as Lockhart and Gummow JJ held, the trade secrets, trade connections and goodwill of Hunter Douglas which constituted the asset for the purposes of para (a). Any of those is capable of constituting such an asset. As Gummow J pointed out, they are 'of a proprietary character and therefore "assets" within the meaning of the definition in s 160A'."[34]

While it can be argued that these comments do not form part of the ratio decidendi of the High Court's decision, it must be noted that none of the judges specifically questioned whether the trade secrets were assets as concluded by the Full Federal Court. Accordingly, both the High Court and Full Federal Court decisions provide considerable support for the conclusion that confidential information is an asset for CGT purposes.

Section 160ZZE Section 160ZZE of the Act deals with the disposal of an asset "in respect of which, or in respect of the acquisition of which, the taxpayer incurred expenditure of a capital nature to which any of"[35] Div 10, Div 10AA or Div 10AAA of the Act applies and "the

32. 91 ATC 4808 at 4817.
33. Ibid at 4823.
34. Ibid at 4825.
35. s 160ZZE(a).

disposal has effect for the purposes of a provision of this Act other than this Part as the disposal of several separate assets".[36] Where these conditions are satisfied the disposal is deemed for CGT purposes to constitute a disposal of the separate assets and the consideration is apportioned for CGT purposes in the same manner adopted for those other provisions of the Act.

The explanatory memorandum which accompanied the amending Act made the following comment. Amongst other things, on s 160ZZE:

> "In line with the current provisions of the Income Tax Law, assets (that is to say 'property') corresponding to the capital expenditure categories which attract income tax deductions and balancing adjustments on disposal will be treated as separate assets for capital gains purposes. Assets corresponding to capital expenditures not so treated as separate assets will fall to be included in the cost base of the prospecting or mining right."[37]

It is possible that the drafter intended this section to make it clear that allowable capital expenditure and exploration expenditure (including expenditure on information) were treated as separate assets for CGT purposes. However, the wording of the section requires a disposal of an asset before it can operate. Consequently, if information is not an asset, the section would not apply to deem anything to occur in respect of the disposal of information.

On the other hand, where the disposal does involve an asset or assets it would be expected that the consideration for CGT purposes would be the same as the consideration for other purposes of the Act in any case. In these circumstances it is submitted that the actual operation or purpose of s 160ZZE of the Act is unclear where there is a disposal of mining information and also where there is a disposal of mining assets.

Section 160M(6) and s 160M(7) Act No 191 of 1992 introduced changes to ss 160M(6) and 160M(7) of the Act. These changes were needed to clarify the operation of those sections following the decision in *Hepples* case which is discussed above. As noted in the explanatory memorandum, these subsections were intended to apply in situations where there was not an actual disposal of an asset. This means that where the provisions apply the whole of the consideration received is treated as a capital gain, as the taxpayer is deemed to have no cost base.

This could potentially create a problem for mining companies if it is ultimately concluded that mining information is not an asset for CGT purposes. Where there is a disposal of mining information for consideration is seems likely that the Commissioner would take the view that there is an event affecting an asset to which s 160M(6) of the Act will apply. In fact, in the explanatory memorandum a list of the circumstances in which the new provisions would apply include, amongst other things, "an agreement for the supply of mining information in the possession of the taxpayer".[38] There is some

36. s 160ZZE(b).
37. Explanatory Memorandum to Act No 52 of 1986.
38. Ibid.

uncertainty as to whether the drafter has taken the view that mining information is not an asset for CGT purposes or whether he or she is simply noting a circumstance where information could be supplied for consideration without a disposal occurring.

It should be noted that if the view is taken that mining information is not an asset, there is an argument that the original s 160M(7) of the Act would apply to tax in full, consideration allocated to mining information. Consequently, any "disposal" of mining information which occurred after 19 September 1985 would be exposed to taxation under that section. Given the Treasurer's detailed press release on the application of the CGT provisions to a disposal of mining tenements and information, this would be an inequitable situation.

Conclusion on capital gains tax The view expressed in the explanatory memorandum to the *Taxation Laws Amendment Act (No 4)* 1992 (Cth) creates further uncertainty for mining companies as it is clearly contrary to the statement made by the Treasurer in May 1986. It is submitted that no matter what the final outcome, mining companies should not be left in a position where the taxation consequences of business decisions are unknown. In particular, based on the different views shown above, a disposal of mining information at cost may not be taxed at all or under the new provisions of s 160M(6) of the Act the whole of the consideration received may be taxable.

It is noted that there is a potential conflict between the conclusion which may be adopted for income tax purposes and the conclusion which is sought for stamp duty purposes. For example, the practical view that the cost of information should be regarded as part of the cost of the tenement may result in the whole of the consideration for a disposal being allocated to the sale of the tenement. An alternative income tax position would be to continue to allocate consideration between the right and the information. In the case where s 160M(6) of the Act applied to tax the consideration allocated to information (which is likely to be more than its original cost) and there was nominal consideration allocated to the tenement it would be argued an equal capital loss would arise on disposal of the tenement and consequently there would be no net capital gain in respect of the total transaction. While this argument produces a fair result, there are problems with the potential application of s 160ZD of the Act which may impose a market value consideration. Where the tenement itself is regarded as more valuable this treatment may result in a taxpayer not obtaining the benefit of indexation of the cost base which may be available if all the consideration was allocated to the tenement.

It is submitted that the introduction of s 122JAA of the Act is consistent with the views expressed in the May 1986 press release. As such, it appears the government's intention is for mining information to be treated as either a separate asset for CGT purposes or in the alternative, the cost of such information should form part of the cost base of the tenement or right. However, in this paper it has been shown that the legislation, the case law and the legislative intent do not always support this conclusion. Accordingly, the law should be amended to

ensure that the consequences for both CGT and Div 10 purposes are certain. The situation of mining companies entering major transactions with only a 1986 Treasurer's press release as authority for the taxation consequences is clearly unsatisfactory.

Treatment of farm-outs

The above matters have dealt with uncertainties in the legislation rather than inequities. The current treatment of farm-outs for Australian taxation purposes creates a situation which it might be argued does not lead to an efficient development of Australia's natural resources and as a consequence would be regarded as clearly inequitable. The most likely provisions which will impact upon a farm-out are ss 122K (of Div 10) and 124AM (of Div 10AA) of the Act and the CGT provisions.

Sections 122K and 124AM Sections 122K and 124AM of the Act have potential application whenever property is disposed of. As property is defined to include a mining or prospecting right, any disposal of such a right may lead to an assessable amount under ss 122K or 124AM of the Act. The disposal consideration may be either the cash amount received, or the market value of the property transferred where a contribution is to be made to future expenditures.

However, an assessable amount will only arise to the extent that taxation deductions have been allowed for exploration or development expenditure. If no such deductions have been claimed in respect of the tenement (because of insufficient assessable income), then these sections will not assess any amount.

Capital gains tax provisions A mining or prospecting right constitutes an asset as defined in s 160A of the Act. Consequently any disposal of a mining or prospecting right, or an interest therein, may lead to an assessable amount under the CGT provisions, where the right was acquired after 19 September 1985 or is deemed to be acquired after this date.[39]

Where the consideration for entering into a farm-out is an amount of cash, this will constitute the consideration for the disposal.[40] The assessable amount will then depend on the indexed cost base[41] of the tenement (or interest therein) to the transferor.

In the Treasurer's press release of 22 May 1986 regarding the taxation implications of farm-outs and Income Tax Ruling IT 2378 "Capital Gains: Mining farm-out arrangements", both of which concern the disposal of mining (and petroleum) exploration and production rights, it is accepted that exploration and development expenditure incurred forms part of the cost base of the rights, and these costs are able to be indexed. Indexation is only available where the expenditure is incurred more than 12 months before the disposal of the tenement.

39. Eg under s 160ZZS.
40. s 160ZD.
41. s 160ZH.

Where no cash is received but the transferee is required to fund future exploration or development expenditure an assessable amount may also arise. Under the CGT provisions,[42] the consideration received is the value of the property transferred. In Income Tax Ruling IT 2378, it is stated that this value is *not* the sum of the future expenditure commitments.

The obvious disadvantage of this approach is that the transferor may be assessed on an amount, and be liable to pay the tax where no cash has in fact been received (by the transferor). Income Tax Ruling IT 2378 mitigates these consequences to a limited extent by accepting that wild-cat or grass roots exploration (that is, high risk stage) properties *should* have a nil value for CGT purposes. Further the Ruling provides that the parties to the transfer may agree on a value for CGT purposes (note that this will be the cost base to the transferee for any future disposal), and providing that the parties are dealing at arm's length this value would generally be accepted.

However, the Ruling states that proven or tested properties (that is, low risk stage) should generally have a market value and this will form the consideration in respect of the transfer. This market value may, as outlined above, be agreed between the parties and not necessarily bear any relationship to the amount of exploration expenditure to be funded.

The determination of market value is therefore crucial unless the parties agree on a valuation and this is acceptable to the ATO. Such a valuation may be required for stamp duty or other purposes, and this may provide the requisite valuation. Alternatively, if these valuations do *not* agree to the CGT value agreed this would be a cause of concern.

Suggested amendments to Australian legislation It is submitted that the present situation concerning the eligibility to CGT of farm-out arrangements in Australia is unsatisfactory. The reasons for this are as follows:

(a) Where a transaction has occurred which results in the receipt of cash by the transferor, then a transaction has taken place which provides the transferor with cash. That cash recognises a gain and the capacity to pay the tax. Where the transaction is in exchange for expenditure commitments, the transferor realises no cash;

(b) Not only is there no realisation of cash in respect of a farm-out in exchange for expenditure commitments, but there is considerable uncertainty as to the values involved. Within the principles of equity, taxpayers have an expectation that the application of taxation laws to normal commercial transactions should be certain. Such is not the case in respect of a farm-out for expenditure commitments. This had led to unsatisfactory practices, including arguments that various acreages have a nil value, largely because it is difficult to determine what the real value is; and

(c) The problem is likely to become significant. A number of farm-outs to date would have either been in respect of mining and petroleum rights granted prior to 19 September 1985 or alternatively, the

42. s 160ZP(2).

administrative expedience of adopting a nil value has been adopted. As time goes on, difficulties will arise. For example, the adoption of a nil cost base may ultimately be contested by the transferee on a subsequent farm-out or a transaction involving the mining or petroleum right.

It is submitted that the procedure in the United States of America (and to a lesser extent the United Kingdom) is more preferable. The United States of America and the United Kingdom treat a farm-out in return for expenditure commitments as being a non-taxable transaction. In the United States of America each partner normally retains a cost base in respect of the mining right. The transferee attains a cost base equal to the expenditure commitments met by it. The transferee retains a cost base reflecting the net cost (after any reimbursement by the transferee) of its investment to date in respect of that mining right. The United Kingdom approach gives a similar result in that no taxable event may occur where moneys are expended by the transferee on future exploration expenditure.

It is thought that the better way to overcome the anomalies noted above is for a specific amendment to cover mining and petroleum rights only. While it is not evident that a general amendment would impact upon other transactions, a specific amendment would give more surety in this regard.

Capital expenditure not deductible

As noted in the discussions above, the primary purpose of the mining provisions is to act as an incentive for the mining industry in Australia and to compensate mining companies for the fact that a substantial portion of their capital expenditure may be on wasting assets. The current Div 10 of the Act was introduced to ensure that deductions were available for all large capital expenditures undertaken by mining companies on mining ventures. However due to a somewhat narrow interpretation of the definition of allowable expenditure contained in s 122A of the Act there are significant capital expenditures incurred by mining companies which do not or potentially may not qualify for deduction under any provision of the Act.

Section 122A(1) of the Act provides that:

> "For the purpose of this Subdivision, allowable capital expenditure of a taxpayer is expenditure of a capital nature incurred by the taxpayer, being—
>
> (a) expenditure in carrying on prescribed mining operations, including expenditure—
>
> (i) in preparing a site for such operations;
>
> (ii) on buildings, other improvements or plant necessary for the carrying on by the taxpayer of such operations;
>
> (iii) in providing or by way of contribution to the cost of providing, water, light, or power for use on, or access to

or communications with, the site of prescribed mining operations carried on, or to be carried on by the taxpayer; or

(iv) on housing and welfare."[43]

This is the major deduction provision under which mining companies are obliged to claim for expenditure incurred and yet as will be demonstrated below the law is far from clear and has significant shortcomings.

Demolition expenditure

From an analysis of s 122A(1)(a) of the Act it would seem that to qualify as allowable capital expenditure it is only necessary for expenditure to be of a general kind incurred in carrying on "prescribed mining operations".[44] The definition is an inclusive one and it is submitted that the intention of subparas (i) to (iv) is to extend this general definition and not to limit it. Accordingly on first sight one would have thought that it should not be considered necessary for the expenditure to fall within one of these subparagraphs to qualify as allowable capital expenditure.

When the Full Federal Court considered the question of whether demolition costs would qualify as allowable capital expenditure in *FCT v Mount Isa Mines Ltd*,[45] Pincus and Ryan JJ, in their joint judgment, considered the deductibility of the costs in relation to each of subparas (i) to (iv) but did not seem to consider whether it would qualify under the general definition. In this regard, it is interesting to note that the learned justices specifically rejected the argument pressed by counsel for the taxpayer because counsel "appeared unwilling precisely to identify which of subparas (i), (ii) or (iii)" applied.[46] The taxpayer sought special leave from the High Court to argue that Div 10 of the Act applied to these costs, however the application was rejected.

Two issues arise in respect of this aspect of the *Mount Isa Mines Ltd* judgment. Firstly, in line with the clear intention of Div 10 of the Act when introduced by Mr McMahon in 1968, the learned justices could have taken a wider approach to the definition of allowable capital expenditure as used in s 122A of the Act. Secondly, and notwithstanding the disappointing narrow approach taken to the section, it would be pleasing to ensure that when such expenditures are incurred as part and parcel of the carrying on of a company's prescribed mining operations that the expenditure in question does in fact fall for deduction either on an outright basis or as allowable capital expenditure.

In relation to the second point, it is perhaps useful to comment upon the potential for a company such as Mount Isa Mines Ltd to obtain a deduction for such expenditure under the rehabilitation provisions

43. s 122A(1)(a).
44. Ibid.
45. 91 ATC 4154.
46. Ibid at 4165.

which were introduced into the Act, applying to expenditure incurred after 30 June 1991. These deduction provisions are included in the Act pursuant to Div 10AB of the Act and the key features may be summarised as follows:

(a) expenditure incurred by a taxpayer to the extent to which the expenditure is in respect of rehabilitation related activities is an allowable deduction in the year incurred;[47]

(b) a "rehabilitation related activity" in relation to a taxpayer is a reference to the restoration (or partial restoration) of a site, on which the taxpayer conducted extractive activities or ancillary activities, to or to a reasonable approximation of the pre-mining condition of the site;[48]

(c) the "pre-mining condition" of the site is the condition the site was in before extractive activities or ancillary activities or both were first commenced on the site whether by the taxpayer or by a predecessor of the taxpayer;[49]

(d) property used for rehabilitation related activities is taken to be used for the purpose of producing assessable income of the taxpayer (which will enable claims to be made for depreciation or capital allowances);[50]

(e) a deduction is not allowable for expenditure incurred on acquiring land, constructing buildings or other structures, for use as a bond or in respect of housing and welfare;[51] and

(f) a deduction for expenditure is not allowable under Div 10AB of the Act if that expenditure qualifies for deduction under any other provision of the Act.

During a tax workshop between the ATO and the Australian Petroleum Exploration Association held in 1992, some of the problems with the rehabilitation and restoration legislation were brought to light and the comment from the ATO was obtained. Areas of particular difficulty relating to the legislation and which could be addressed in a review of the legislation are as follows:

(a) circumstances may arise where rehabilitation of an activity which is related to prescribed mining operations may be excluded from qualifying as rehabilitation pursuant to Div 10AB of the Act. This would appear to be an anomaly as the intention of the legislation is that expenditure incurred by a taxpayer after 1 July 1991 anywhere on the mine site to the extent to which it is in respect of rehabilitation-related activities is an allowable deduction.

    The difficulty is that the definition of rehabilitation related activity refers only to restoration of the site on which the taxpayer conducted extractive activities. Extractive activities are defined to be limited to prescribed mining operations. It does not extend to the

47. s 124BA(1).
48. s 124BB(1) and (1A).
49. s 124BB(2).
50. s 124BF(1).
51. s 124BC.

treatment of the products from prescribed mining operations although such may well have been covered under the definition in the pre-1968 Act. Because the present Division limits deductions to extractive activities as so defined, treatment facilities on a mine site as defined in Div 10 of the Act are potentially excluded;

(b) based on discussions at the abovementioned workshop, the cost of moving plant and equipment to enable the conduct of rehabilitation work would seem to be a prerequisite to the carrying out of rehabilitation work and would not fall within the scope of rehabilitation activity;

(c) the expenditure incurred in cleaning up an environmental disaster which occurs during the off-site transport of minerals or petroleum is not within the scope of the rehabilitation provisions.

All in all it would seem that whilst the rehabilitation provisions introduced in Div 10AB of the Act go some way towards providing deductions for mining and petroleum companies post 1 July 1991, the provisions in themselves have anomalies which should be corrected by legislation rather than waiting for judicial interpretation.

Upgrading public access roads

The narrow interpretation of the definition of allowable capital expenditure can be further demonstrated in the example of a mining company which upgrades a public access road to the mine site. However, as all the minerals mined are transported to the port by rail the company cannot rely on Div 10AAA of the Act to allow a deduction for the cost of upgrading the road.

On an initial review, it would appear that the cost of the road would fall within para (iii) of s 122A(1)(a) of the Act and in fact the explanatory memorandum stated that s 122A(1)(a)(iii) of the Act "specifically provides for the inclusion in allowable capital expenditure of expenditure in providing access roads . . . to the site of the extractive operations".[52] However the ATO has taken a restrictive interpretation of the meaning of prescribed mining operations and contend that the cost of access roads will only qualify as allowable capital expenditure if the access roads are actually situated on the mining property.

It is interesting to compare the ATO's interpretation of this situation with the original intention of the legislature as indicated in the Second Reading Speech:

> "The location of some facilities on which mining enterprises incur capital expenditure may, under the existing provisions, play an important part in determining whether special deductions for the expenditure are or are not allowable. The result is that expenditures of the same kind may be treated differently for taxation purposes according to whether the facilities are in the mining area or somewhere else. The government has come to the view that it is no longer generally appropriate for tests of this kind to apply for the

52. Explanatory Memorandum to the *Income Tax Assessment Act (No 2)* 1968 (Cth).

purpose of deciding whether or not capital expenditure on these facilities is deductible. We have therefore decided that the existing provisions should be re-written so that the location of the facilities is clearly not a decisive factor."[53]

Compensation payments

A further example of the current restrictive interpretation of the definition of allowable capital expenditure can be seen in the treatment of compensation payments that mining companies are required to make to landowners surrounding a mine site.

In areas where mining is carried on close to townships, such as the Hunter Valley region of New South Wales, it is not uncommon for mining companies to be required by the local council to make payments to landowners who may be affected by noise and dust and in fact are often required to purchase the affected properties at market value if the owner so requests.

In these situations the ATO does not consider that the compensation payments or costs of purchasing the properties constitutes allowable capital expenditure. The ATO contends that the expenditure is merely incurred while carrying out mining operations rather than being incurred in the actual carrying out of the operations, and cites *Utah Development Co v FCT*[54] as authority for this proposition.

While it is not necessarily suggested that the ATO's technical interpretation of the definition of allowable capital expenditure is incorrect, it is submitted that to take such a restrictive approach is contrary to the intention of the mining provisions. It can be seen from both of the above situations that the result of the taxpayer not being able to include the expenditure as allowable capital expenditure is against the intention of the mining provisions. The appropriate solution is for the legislation to be amended to ensure that the definition of allowable capital expenditure is wide enough to include all capital expenditure which mining companies incur directly in relation to their mining operations.

Mabo and other access payments

With the possibility of *Mabo* compensation and other access payments being brought forward for consideration, it is relevant to analyse the deductibility of such expenditure under the present provisions of the Act. These types of payments were discussed by the ATO in Income Tax Ruling IT 2642 which dealt with mining exploration and prospecting expenditure:

"11. Expenditure on or in relation to the acquisition of rights to enter upon an area with a view to exploration or prospecting thereon does not qualify for deduction under sections 122J or 124AA. Neither is it deductible as allowable capital expenditure

53. Second Reading Speech to the Income Tax Assessment Bill (No 2) 1968 (Cth).
54. 75 ATC 4103.

under sections 122A or 124AA because the acquisition of those rights is not made under the section 122B or 124AB notice as referred to in paragraph 6 herein. Examples of expenditure in this category are:

1. survey fees to check the mineral claim areas;
2. advertising to comply with mining regulations;
3. attending at Court hearings to confirm rights;
4. payment to holders of tenements for abortive options;
5. buying-in and compensation payments to landlords for rights to enter property;
6. application fees for exploration licences;
7. legal costs in connection with (v) and (vi) above; and
8. costs incurred in negotiating and effecting farm-out arrangements.

12. It is considered that expenses relating to the acquisition of exploration or prospecting rights are clearly of a capital nature in the case of a mining company having the general intention of developing any discoveries made. In such cases, expenses of the kind listed in paragraph 11 would not be deductible under subsection 51(1)."[55]

It can be seen that in certain circumstances a mining or petroleum company will have significant difficulty in claiming a deduction under either the capital expenditure provisions or s 51(1) of the Act in respect of access payments which may be required under such compensation legislation as is proposed following *Mabo*.

It is suggested that this is clearly an area where the legislation needs to be amended to ensure that such expenditures which are required to be paid by mining companies are dealt with on a properly allowable basis either as an outright deduction or alternatively as an amortising deduction over the life of the mine or some other appropriate time period.

AUSTRALIAN TAXATION OFFICE'S APPROACH TO MINING

As discussed above, the self-assessment system has placed the burden of determining the correct income tax treatment of a particular item on the taxpayer. Obviously, a taxpayer will be liable to pay penalties if they are subsequently found to have a tax shortfall and they do not have a reasonably arguable position. Pursuant to s 222D of the Act, a public ruling issued by the Commissioner is a relevant authority for the purposes of determining if a particular position is in fact reasonably arguable. In addition, the self-assessment provisions provide that if a taxpayer disregards a private ruling issued by the ATO then any penalties imposed in respect of a taxation shortfall will be increased.

55. Income Tax Ruling IT 2642, paras 11, 12.

The result is that unless a mining company decides to expend the considerable time and money involved in challenging an ATO ruling in the Administrative Appeals Tribunal or the courts, it is exposing itself to the considerable risk of increased penalties if it chooses not to follow a ruling. Again, this places a considerable burden on mining companies especially in view of some of the recent rulings issued by the ATO.

In this part of the paper it is intended to comment upon some perceived difficulties with the ATO approach that there has been evident in some rulings issued under both the old income tax ruling system and the new binding public ruling system.

Draft Taxation Determination TD 94/D7—overburden removal

The Draft Taxation Determination TD 94/D7 issued by the Commissioner on the taxation treatment of expenditure incurred by a mining company on the removal of overburden in open-cut mining, states that expenditure incurred in the initial cut in an open-cut mine is considered to be capital in nature. The draft determination states that the initial removal of overburden is analogous to the sinking of a mine shaft to gain access to the ore. *Mount Isa Mines Ltd v FCT*,[56] *Bonner v Basset Mines Ltd*,[57] and *Coltness Iron Company v Black*[58] are cited as authority for the conclusion that expenditure on the sinking of a mine shaft is capital in nature.

While it is considered that the sinking of a mine shaft would generally be capital, it is submitted that the draft determination fails to provide any authority or conceptual reason to support the analogy between the sinking of a mine shaft and the initial cut in an open-cut mine. It would seem just as relevant to draw an analogy between open-cut mining and the "decline" mining method which was held to be revenue in the *Mount Isa Mines* case.

The correct treatment of the initial cut in an open-cut mine is not free from doubt. A great deal of contradictory authority exists, most of which dates before the First World War. In this circumstance, it is submitted that the ATO view is rather narrow and perhaps it may be more equitable not to release a final version of the determination before the question has been decided either by the courts or by legislative amendment.

Draft Taxation Ruling TR 93/D11—absorption costing for the mining industry

This Draft Taxation Ruling released by the Commissioner discusses the application of the absorption costing method of valuing the cost of trading stock on hand for the purposes of s 31 of the Act. The draft

56. [1991] ATC 4154.
57. (1912) 6 TC 146.
58. (1881) 1 TC 287.

ruling is specifically directed at the mining industry, and in the ruling the Commissioner contends that the costs of employee benefits such as cafeteria running costs, first aid and township costs are to be treated as costs of production and thus included in the cost of trading stock.

This draft ruling is a change from the interpretation of *Philip Morris Ltd v FCT*[59] which the Commissioner set out in Income Tax Ruling IT 2350. In IT 2350 the Commissioner stated that employee benefits should not be absorbed into the cost of trading stock.

It is considered that the ATO has taken on an aggressive approach by releasing a draft ruling with special reference to the mining industry, which sets out a harsher treatment than the long-standing ruling with general application. It is difficult to reconcile the difference in treatment between mining and non-mining companies. Many have suggested that the difference in treatment may be explained by the large amounts of expenditure that mining companies incur on employee facilities. With due respect, it is hoped that if the ATO stands by the draft ruling a more plausible explanation is given.

Taxation Ruling TR 92/19—exemption of income derived by bona fide prospectors

Taxation Ruling TR 92/19 deals with the exemption available to bona fide prospectors under s 23(pa) in respect of income derived from the sale, transfer or assignment of rights to mine for gold or other prescribed metals or minerals. The ruling correctly states that the test to determine whether a taxpayer is a bona fide prospector only applies to the "field work of prospecting".[60]

The ruling states that only work done on, above (aerial surveys) or below (drilling and shafts etc) the tenement is applicable and that 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.[61]

This approach by the ATO is not relevant to the modern-day techniques of exploration and prospecting which involve much laboratory testing and computer modelling.

Draft Taxation Determination TD 94/D45—elections under ss 122DG, 122JE and 122ADG

Draft Taxation Determination TD 94/D45 considers the operation of the election provisions contained within ss 122DG, 122JE and 122ADG.[62] Under s 122DG(6) deductions are limited to the amount of assessable income of the taxpayer less all other allowable deductions.

59. 79 ATC 4352.
60. Taxation Ruling TR 92/19, para 3.
61. Ibid, para 33.
62. Reference in the following paragraphs will be made to s 122DG only. The comments apply equally to the relevant provisions contained within ss 122JE and 122ADG.

The taxpayer may elect to claim a deduction under s 122DG(6A) and thereby create a loss in a year of income. The determination states that any election made in a year of income relates only to expenditure incurred in that year and not to any amounts carried forward from previous years. The determination cites the explanatory memorandum as support for this proposition.

However a reasonable alternative interpretation does exist. Expenditure incurred in previous years and now carried forward is deemed to be an allowable deduction in the next succeeding year of income.[63] Accordingly, the alternative interpretation suggests that an election may be made in respect of the amounts carried forward. Section 122DG(6C) seeks to prevent this interpretation, though on reading the section, it seems only to apply in respect of the previous year.

The approach adopted by the ATO is clearly inappropriate given the lack of clarity and the circular nature of s 122DG(6C). The Commissioner has attempted to clarify the operation of the section by relying on the explanatory memorandum. However the section is inherently unclear and obscure and should not be the subject of a determination. Rather, the operation of the section should be amended by legislation, to ensure both certainty and clarity.

CONCLUSION

Assuming it is the government's wish that the mining and petroleum industry continues to remain competitive on a worldwide basis, the examples which have been set out above of both inequity and uncertainty demonstrate the need for a major review of the taxation system as it applies to mining and petroleum companies.

Mr McMahon in his Second Reading Speech in 1968 highlighted that the special circumstances of the mining industry should be acknowledged through special provisions in the taxation law. He also acknowledged that the need for such recognition was of particular importance in the case of the mining industry because of the impact on the Australian economy. There would seem to be no doubt that the legislative intention of the present Div 10 has failed. The objective of an efficient taxation system which has the principles of equality, certainty and simplicity are not present in the current-day environment.

As was the case in 1968, there would appear to be no alternative but to embark on a major rewrite of the mining and petroleum provisions to ensure that the principles of an effective taxation system as outlined above are achieved. Such a major rewrite would also necessitate incorporating other problems in related legislative provisions, such as CGT, into the process.

The government must hear the plea of the mining industry. There is no doubt that a major rewrite of the mining and petroleum provisions

64. s 122DG(7).

will not be embarked upon unless the government hears of the problems outlined above. Major lobbying is necessary. Industry bodies such as AMPLA and AMIC and other representative bodies should join together with a unified voice and lobby the government to make the changes necessary to simplify and provide certainty under the mining taxation system.

Some may suggest that such lobbying will not bring about the necessary changes. I trust that this paper has demonstrated the overriding requirement that change is necessary. All that is required is the combined will of the industry to force the government to implement a much overdue review. Change can be effected. Witness the outdated approach to exploration expenditure as was evident in the Income Tax Ruling IT 2682. Such definition of exploration was subsequently changed to remove the requirement that exploration be "on tenement".

In the words of William Shakespeare, "Nothing comes from doing nothing".