GST implications of immediate transfer farm-out arrangements

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The ATO draft GST ruling on immediate transfer farm-out arrangements has clarified the GST treatment but has instituted new GST accounting requirements.

Background

On 27 July 2011, the Commissioner of Taxation issued Draft Miscellaneous Taxation Ruling MT 2011/D1 - Miscellaneous taxes*: application of the income tax and GST laws to immediate transfer farm-out arrangements.*

The Draft Ruling sets out the Commissioner's preliminary views on the application of the GST (and income tax) provisions to *immediate* transfer farm-out arrangements that are applicable to the mining and petroleum resource sector.

Importantly, the Draft Ruling only deals with *immediate* transfer farm-out arrangements of the type described in the Ruling.

Consideration should be given to the GST implications of arrangements not covered by the Ruling. For example, the Ruling does not apply to *deferred* transfer farm-out arrangements, which are arguably more common in a mining context, and will be the subject of a separate ruling (*MT 2011/D2)* that is scheduled to be issued on 24 August 2011.

What is the Commissioner's view?

Assuming the basic requirements for a taxable supply or a creditable acquisition (as the case may be) are satisfied, the Commissioner takes the following preliminary view:

- The farmor makes a taxable supply of the interest in the mining tenement to the farmee and has a GST liability. The farmee makes a creditable acquisition of the interest and is entitled to an input tax credit.
- Similarly, the farmee makes a taxable supply of exploration benefits to the farmor and has a GST liability. The farmor makes a creditable acquisition of the benefits and is entitled to an input tax credit.
- Where separate consideration is attributed to the sharing of mining information, the farmor makes a taxable supply of that mining information and it is a creditable acquisition for the farmee.

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- If the parties are dealing with each other at arm's length, the value of the transactions will be the market value of non-monetary consideration (representing the value of the supply received from the other party) plus any monetary consideration.
- The farmor and farmee may be able to exchange tax invoices upon entering into the agreement, with the GST and input tax credits being attributed to that tax period, and thereby offsetting each other.

What are the implications?

While the Commissioner has emphasised that the various transactions should result in an offsetting GST position for each party (giving rise to a nil net GST outcome), this only occurs where a number of conditions are satisfied including both parties accounting for GST on the same basis and having a fully creditable purpose.

Where all of these conditions are not satisfied, a permanent GST cost may arise.

Further, the transaction will give rise to a cash flow cost where the farm-out involves a GST-free supply of a going concern (which includes the supply of the interest in the mining tenement) with no monetary consideration provided between the parties. Whilst the farmor will have no GST payable in respect of this supply (and no entitlement to input tax credits will arise for the farmee), the farmee will need to account for GST on its supply of the exploration benefits to the farmor.

What should I do?

Consider the GST implications of immediate transfer farm-out agreements to be signed on or after 27 July 2011 to ensure that no adverse implications arise or suitable mitigation strategies are put into place.

Ensure correct accounting for GST and input tax credits and that tax invoices are provided and received upon entry into the farm-out arrangement. This will likely require changes to current administrative practices.

Further information:

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