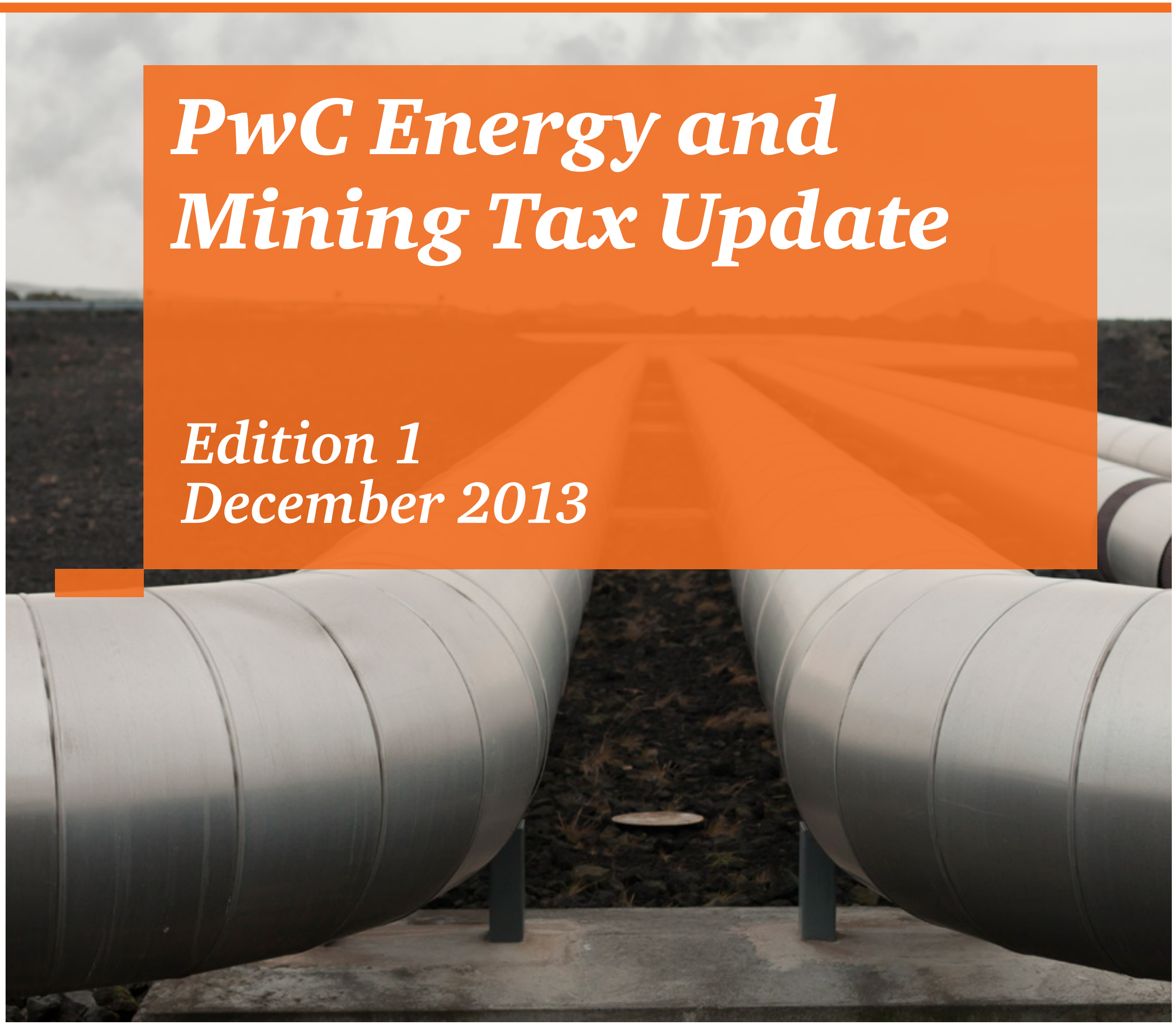


PwC Energy and Mining Tax Update

Edition 1
December 2013

Welcome

Keeping you updated on key tax developments in the mining and energy sector, and what these changes mean for you and your business.

Welcome to this first edition of PwC's Energy and Mining Tax Update.

With State and Federal budgets facing long-term deficits, governments at all levels in Australia are looking to the energy and mining sectors as potential contributors of additional revenue. In this edition, we look at some of the measures that will have an impact on companies in terms of changes in tax law and in the approach of revenue authorities to the administration of existing laws. The overwhelming majority of these changes will adversely impact the economics of resource projects in Australia.

All participants in industry expect to pay, and do pay, at least their fair share of taxes to all level of governments. Our view is that the raising of relatively inefficient taxes (such as income taxes, state royalties, stamp duties on transfers) is likely to have the effect of reducing development options and growth opportunities for major new projects in Australia and will reduce the overall tax take in the long term.

At PwC our vision is "To realise and discover the potential of...". In this respect, the challenge for governments and public policy makers is to work with industry and community leaders to sell the benefits of genuine tax reform - so that the burden of increased taxes is focussed on areas which have a reduced chance of putting at risk the great potential of Australia's natural resource endowment.

James Strong
Energy & Mining Tax leader
+61 (3) 8603 6599
james.r.strong@au.pwc.com

State Taxes
Income Tax
Resource Rent Taxes
Transfer Pricing
Research and Development
Indirect Taxes
Sustainability and Climate Change
Tax Controversy
In this issue
Read more

In this issue

State Taxes

Uncertainty in royalty regimes and disputes process – the need for legislative reform

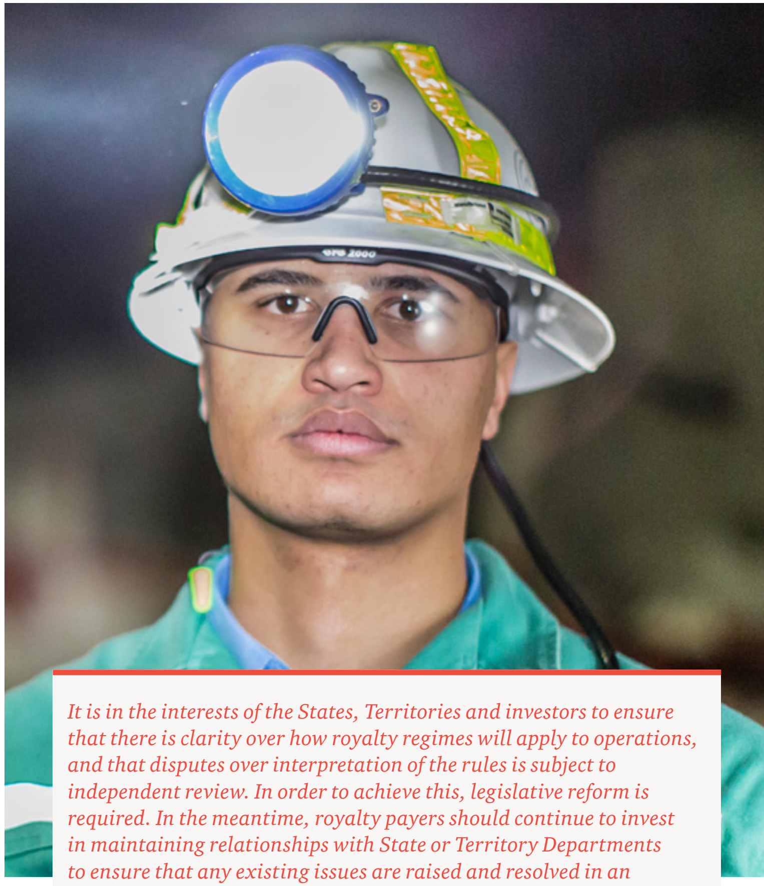
State based royalties represent a significant cost for companies operating resource projects in Australia. However the rules that apply in calculating royalties and administering these royalty regimes often lack the level of detail and contestability that is commonly found in other fiscal regimes (e.g. State based stamp duty regimes). Particularly for more complex royalty regimes, legislative reform is needed to provide greater transparency and certainty around how such royalties will be calculated and to provide an expanded ability to seek independent review of royalty assessments. In the meantime, royalty payers will need to continue to engage with the relevant State or Territory Departments to agree fair and practical methodologies for approaching their royalty obligations and to carefully consider the best strategy for managing any disputes.

The legal basis for a liability to pay a petroleum or mineral royalty is contained within the relevant State or Territory legislation. For example, in New South Wales, Part 14 of the Mining Act 1992 (NSW) requires holders of mining leases to pay royalties as calculated under that Act. A return must be lodged by the lease holder specifying the relevant information with a certificate being subsequently issued by the Minister of Finance (often by a delegated authority) which is due evidence of the royalty owed to the Crown.

There are a range of uncertain issues associated with the calculation of royalties, including the appropriate value of the resource at the relevant 'taxing point' (particularly where no arm's length sale takes place at that 'taxing point'), the ability to claim deductions for particular 'allowable' expenses and the level of substantiation that is required to support the royalty payer's assessment of its royalty liability. These concepts are often considered through a mix of State regulations, Ministerial decisions and / or policy statements.

However, unlike the Federal income tax or State duty systems, there is no defined objection or dispute process contained within the legislative regimes for State or Territory royalties. In particular, there is no legislative mechanism to seek an independent review of the decision from within the State or Territory Department, or a process of lodging an objection to the royalty assessment (with the exception of Tasmania where an appeal may be lodged to the Mining Tribunal).

To dispute the assessment a royalty payer would need to seek the Court's exercise of discretionary administrative law remedies following a judicial review of the decision made by the Department under the relevant State or Territory enactment. In some States, the right of judicial review is found in separate legislation enacted in that State or Territory (such as in Queensland, Tasmania and the Australian Capital Territory (ACT)). In Queensland, the legislative right of review is found in the Judicial Review Act 1991 (Qld). However, NSW (for example) does not have a legislative regime for judicial review with common law principles applying in a review of the administrator's decision by the Supreme Court of NSW. Putting aside these complex differences between the State and Territory regimes, the key message is that the process of disputing a royalty assessment is unclear and in need of legislative reform.



It is in the interests of the States, Territories and investors to ensure that there is clarity over how royalty regimes will apply to operations, and that disputes over interpretation of the rules is subject to independent review. In order to achieve this, legislative reform is required. In the meantime, royalty payers should continue to invest in maintaining relationships with State or Territory Departments to ensure that any existing issues are raised and resolved in an appropriate manner. To the extent conflicts arise, royalty payers will need to carefully consider their options given the often complex basis for legal challenge under existing regimes.

Judy Sullivan, Sydney
Partner
T: +61 (2) 8266 0197
E: judy.sullivan@au.pwc.com

James O'Reilly, Brisbane
Partner
T: +61 (7) 3257 8057
E: james.o'reilly@au.pwc.com

Stamp duty developments target the mining, resources and infrastructure sectors

Australian States and Territories are concentrating on protecting and growing their revenue take, while the Courts are deliberating on fundamental concepts.

Apart from the deferral of the abolition of some forms of stamp duty, some of the recent developments in stamp duty in Australia have centred on the fundamental concepts of correctly determining a liability, properly quantifying the value of a liability and satisfactorily reporting a liability.

Given the significance of real property in a revenue-raising context, it is not surprising that many recent legislative developments have affected the mining and resource sectors, while important recent judicial developments have related to infrastructure projects.

Notable developments in this regard include:

- Queensland introduced exemptions relating to 'farm-in' arrangements and transfers of interests in an exploration authority under both deferred and up-front 'farm-in' arrangements.
- Western Australia introduced new measures relating to interim assessments which can be issued where the determination of a stamp duty liability would likely take longer than 6 months (and a taxpayer cannot object within 3 years after the issue of the interim assessment).
- Certain states have widened the definition of 'land' in their stamp duty statutes to include mining tenements, and in some states, this definition (for landholder duty purposes) also includes an item that is 'fixed to land'.
- The Federal Court set out useful guidance on valuation methodologies for mining projects and how assets – including mining information and goodwill – are to be properly valued.
- The Victorian Court of Appeal held that certain payments relating to infrastructure and construction works, and made in addition to the purchase price under a land sale contract, did not form part of the consideration for the transfer of land.
- The New South Wales Court of Appeal held that tolling rights were not (for landholder duty purposes) an item of property separate to land – this would have implications in a resources context where there are dealings involving bundled property rights.

Barry Diamond, Melbourne
Partner
T: +61 (3) 8603 1118
E: barry.diamond@au.pwc.com

Alexander Galanos, Melbourne
Director
T: +61 (3) 8603 0504
E: alexander.galanos@au.pwc.com

George Papadakos, Perth
Director
T: +61 (8) 9238 3232
E: george.papadakos@au.pwc.com

Given the fluid state of the stamp duty laws in Australia, and inconsistent administration of these laws by the various revenue authorities, there is a real opportunity to minimise stamp duty leakage (or to obtain a duty refund) by correctly applying the fundamental concepts and principles to a transaction.

State Taxes
Income Tax
Resource Rent Taxes
Transfer Pricing
Research and Development
Indirect Taxes
Sustainability and Climate Change
Tax Controversy
In this issue
Read more

Income Taxes

Federal Government responds to announced but not enacted tax measures – What this means for the energy and mining sector?

The Government's recent tax law changes will impact costs for companies in the sector.

On 6 November 2013 the Federal Government announced its response to 92 tax and superannuation measures that have been announced by previous Federal Governments but which remained unenacted.

Key aspects of those announcements for the energy and mining sector include:

Measures that will proceed as announced

- Tightening and improving the thin capitalisation rules for income years commencing on or after 1 July 2014. This will include:
  - Reducing the safe harbour debt to equity ratio from 3:1 to 1.5:1 (i.e. 75 per cent to 60 per cent on a total debt to total Australian adjusted net asset basis)
  - Reducing the worldwide gearing test ratio for outbound investors from 120 per cent to 100 per cent
  - Extending the worldwide gearing test to 'inbound investors', and
  - Improving the operation of the arm's length debt test (this is currently the subject of a Board of Taxation Review).
- Denying the immediate deductibility of the cost of mining rights and information 'first used' for exploration. The tax cost of such rights will be deductible over the shorter of 15 years or the life of the project to which they relate where the rights and information were acquired under an arrangement that commenced on or after 14 May 2013. A carve-out will be put in place to preserve the existing treatment of 'genuine farm-in' arrangements.
- Expanding the scope of the capital gains tax (CGT) regime (with effect from 14 May 2013) for non-residents investing indirectly in Australian real property (including mining and resource projects). These amendments are designed to prevent non-residents from seeking to argue that their subsidiaries which hold mining projects are not 'land-rich' entities (and therefore not subject to CGT) by:
  - Including the value of mining information and associated intangibles in the value of the 'land' assets for CGT purposes, and
  - Excluding the value on any inter-group transactions within a consolidated group.
- Introduction of a non-final withholding tax regime where foreign residents dispose of assets that give rise to an Australian tax liability. The purchaser will be required to remit to the Australian Taxation Office (ATO) an amount equal to 10 per cent of the purchase price. These amendments are intended to apply with effect from 1 July 2016.
- Not proceeding with the proposed repeal of section 25-90 – which provides for a tax deduction for interest incurred on borrowings used to fund investment in overseas projects. Instead a 'targeted anti-avoidance measure' will be introduced, following consultation by Treasury and the ATO.
- Amendment of the scope of section 23AJ dividend exemption so that it will no longer apply to a return on a 'debt interest' issued by a foreign company, but will apply to returns on equity interests.

PwC welcomes the Government's commitment to resolve the uncertainty that surrounds these announced amendments that have not been legislated – particularly as regards the controversial proposal to deny deductions for funding offshore projects – however, at the time of writing, the future of a large number of measures have not yet been announced.

James Strong, Melbourne
Energy & Mining Tax Leader
T: +61 (3) 8603 6599
E: james.r.strong@au.pwc.com

It will be important to model the impact of the tightening of the thin capitalisation rules particularly where reliance is placed on the safe harbour debt test. This is particularly relevant where the cost of large scale capital projects is increasing beyond initial estimates.

The impact of the removal of the deductibility for the cost of acquisition of exploration rights and related information should be considered. For those that acquired exploration rights prior to 14 May 2013, the changes may provide support as to the validity of their previous claims.

Structures should be reviewed to determine whether the proposed changes to the capital gains tax regime that applies to non-residents could result in shares held by non-residents that currently do not fall within the Australian tax net, now being subject to Australian tax on disposal. For those that disposed of shares in a company with an Australian resources project prior to 14 May 2013, the changes may support the case that no CGT liability should arise – subject to the outcome of the Commissioner's Full Federal Court appeal in the RCF case (due to be heard in February 2014).

For those funding off-shore development projects with either debt or equity, the proposed changes to the treatment of returns paid by foreign subsidiaries should be monitored carefully.

State Taxes
Income Tax
Resource Rent Taxes
Transfer Pricing
Research and Development
Indirect Taxes
Sustainability and Climate Change
Tax Controversy
In this issue
Read more

Tax consolidation changes – New and old challenges for the resources sector

As the old 'rights to future income' (RTFI) saga approaches its end with a final ATO flurry, we await new legislation to implement further income tax consolidation changes with effect back-dated to May 2013.

The old

29 June 2014 is the deadline for the making of amendments (where otherwise out of time) as a consequence of the 2012 provisions which 'unwound' the RTFI and residual tax cost setting rules. Well aware of this approaching deadline, the ATO has issued a large number of detailed questionnaires to companies which it believes may have made claims under affected rules.

Having responded to the first set of questions, some companies are now working through follow-up questions; while others have been notified of an impending ATO audit focused on aspects of the RTFI and residual tax cost setting rules.

There are a number of key issues which the ATO has in its sights:

- Deductions claimed for non-contractual intangibles such as 'over-burden removal' and 'customer relationships'. The ability to claim these deductions was removed with retrospective effect by the 2012 amendments.
- Deductions for 'in-the-money' non-TOFA derivatives (i.e. derivatives not subject to the taxation of financial arrangements (TOFA) regime). Many tax consolidated groups, and multiple entry tax consolidated groups (MECs) have claimed deductions for the reset tax cost of non-TOFA derivatives (including commodity, interest rate and currency swaps and options). The ATO has released Interpretative Decisions (ATOID 2013/46 and ATOID 2013/47) adopting a position that such deductions are not available for commodity swap contracts.
- Utilising a CGT cost base for the reset tax cost of non-deductible RTFI assets (under the 'pre-rules'). When the dust settled after the 2012 'unwind' amendments, taxpayers ended up not only without a deduction for RTFI assets, but with no direct CGT cost base for assets such as customer contracts.
- An RTFI deduction claimed under the 'interim rules' should be carefully reviewed to adjust the claim for any value attributable to a period beyond the time the relevant contract could be unilaterally cancelled by the customer.
- An RTFI deduction claimed under the 'interim rules' will not be protected (according to the ATO) to the extent the group was in a tax loss position for the relevant year.

The new

The new Federal Government has confirmed that they will proceed with tax consolidation changes announced by the last Government in the May 2013 Federal Budget and that these changes will still apply from 14 May 2013.

While we know that Treasury has been working on draft legislation, it is not certain whether we will see that legislation before the end of 2013. In the meantime, groups currently considering transactions need to pre-empt the potential impact. The most relevant changes are as follows:

- Deductible liabilities (such as provisions for annual leave and long service leave) held by an entity joining a tax consolidated group (or a MEC group) will result in assessable income being taken up by the group equal to the amount of the deductible liabilities (over 12 months for 'current' deductible liabilities, and over 48 months for 'non-current' deductible liabilities).
- Where a non-resident transfers an entity to a tax consolidated group (or a MEC group), the assets of that entity will not be reset where the following circumstances exist:
  - the interests in the entity are not regarded as 'Taxable Australian Property', and
  - there has been no change in the underlying majority beneficial ownership of the entity in the previous 12 months.

Other potential changes to the MEC group rules, recommended in the 2012 Board of Taxation Report, are still being considered by the new Government.

Wayne Plummer, Sydney
Partner
T: +61 (2) 8266 7939
E: wayne.plummer@au.pwc.com

In this issue
Read more

Exploration Development Incentive – Limited relief for greenfields exploration

Providing tax relief for investors who contribute to the development of Australia's next generation of mines.

In the lead up to the 2013 Federal Election, the Coalition released its policy for resources and energy: Central to this was the announcement of an 'Exploration Development Incentive' (EDI), a proposal that would allow investors to deduct the expense of mining exploration against their taxable income.

Whilst the announcement was short on detail, the key features of the EDI are as follows:

- It provides a tax credit for Australian tax resident shareholders for eligible 'green fields' exploration expenditure incurred in Australia.
- It applies for investments made on or after 1 July 2014.
- It does not apply for companies that have taxable income.
- The ATO will determine a proportion of expenses that can be claimed as tax credits by investors.
- It would be capped at $100 million over the Government's 'forward estimates'.

The final design of the incentive is to be determined in consultation with peak industry bodies.

Speaking in Perth in November 2013, Will Robinson, the President of the Association of Mining & Exploration Companies (AMEC), made the following observations:

"The Canadians have proven that with the right policy settings, developed nations can attract new exploration capital and increase their share of exploration investment… the proposed Exploration Development Incentive is a timely and much needed catalyst for the industry".

Matt Budge, Perth
Partner
T: +61 (8) 9238 3382
E: matthew.budge@au.pwc.com

Olivier Marion, Perth
Director
T: +61 (8) 9238 5115
E: olivier.g.marion@au.pwc.com

PwC is interested the final design of the incentive.

Unlike the Canadian scheme, which is generally implemented in a way that gives a tax deduction to the investor at the time of capital contribution, the current EDI proposal relies both upon the ATO determining what expenditure is eligible, and the company choosing to pass on the tax credit to its shareholders.

In our view, these two barriers may lead to investors discounting the value of the credit when making investment decisions, potentially to a point that they may not invest in the first place. If this were to be the case, there is a risk that the incentive would not achieve its objectives.

PwC considers that the consultation process should canvass ways for the entitlement to the credit being placed within the control of the investor, with appropriate safeguards to protect the $100 million cap over the forward estimates. The value of the credit should be maximised in the hands of the investor at the time of investment to ensure it provides the intended incentive to invest in the further development of Australia's mining industry.

Resource Rent Taxes

ATO's preliminary view on definition of 'exploration' for PRRT

Participants in the Australian oil and gas industry continue to face considerable uncertainty regarding the operation of the Petroleum Resource Rent Tax (PRRT) regime. The recent Administrative Appeals Tribunal (AAT) decision in *ZZGN v Commissioner of Taxation* [2013] AATA 351 (the ZZGN case) has highlighted that there is an apparent disconnect between the way in which the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA) is interpreted, and the manner in which the ATO have administered the PRRT.

In the absence of a formal ATO view on the definition of 'exploration' as it applies to the PRRT, taxpayers may in the past have sought to rely on their understanding of the ATO's interpretation of the meaning of 'exploration' for PRRT purposes, applying either a 'bright line' test such as a Final Investment Decision (FID) or the ATO's official view in taxation ruling *TR 98/23* of the definition of 'exploration' in the *Income Tax Assessment Act 1997* (ITAA 1997). However, following the decision in the ZZGN case taxpayers now have to consider analysing each item of expenditure to identify whether the item qualifies as exploration expenditure for PRRT purposes.

On 21 August 2013, the ATO issued a draft Taxation Ruling TR 2013/D4 which sets out the Commissioner of Taxation's preliminary view in respect of the meaning of the phrase: "*... involved in or in connection with **exploration for petroleum** ...*" [emphasis added] in paragraph (a) sub-section 37(1) of the PRRTAA. The view is broadly consistent with the outcomes in the ZZGN case:

- The definition of 'exploration for petroleum' takes its ordinary meaning (for the purposes of section 37 of the PRRTAA).
- The meaning is limited to the discovery and identification of the existence, extent and nature of petroleum – this includes searching in order to discover the resource, as well as the process of ascertaining the size of the discovery and appraising its physical characteristics.
- The drilling of an appraisal well to evaluate the physical extent and nature of a find is provided as an example of exploration expenditure within the ordinary meaning.
- Economic evaluation activities such as post-discovery feasibility studies of a petroleum field (for future development and production) do not fall within the ordinary meaning of 'exploration'. The words 'involved in or in connection with exploration for petroleum' do not extend the scope of section 37 of the PRRTAA to include such activities.
- There is no 'bright-line' test in determining whether an amount constitutes 'exploration'.

A key issue to be addressed in finalising TR 2013/D4 is the date from which the finalised Taxation Ruling will apply. It is currently proposed that once finalised, the Ruling will apply to payments made from the date of issue of the draft Ruling (i.e. from 21 August 2013). The draft Ruling is silent on what view the ATO will take in respect of payments made prior to 21 August 2013, but the ATO has indicated that in the interim (until the Taxation Ruling is formally published as final) it would apply the principles from the ZZGN case.

David Lewis, Perth
Partner
T: +61 (8) 9238 3336
E: david.r.lewis@au.pwc.com

Sara Mattsson, Perth
Director
T: +61 (8) 9238 3671
E: sara.e.mattsson@au.pwc.com

Taxpayers should consider revisiting the treatment of current exploration expenditure under section 37 of the PRRTAA. Taxpayers should consider their current project economic assumptions included in any financial models to ensure that only eligible costs are carried forward and uplifted (or transferred) as exploration expenditure.

Taxpayers should consider their ability to support historical PRRT deductions claimed and review their:

- *PRRT assessments for years which remain open for amendment*
- *Transfer Notices*
- *The balance of un-deducted PRRT expenditures carried forward*
- *Financial models used for investment decisions, tax accounting and impairment testing*
- *Prior period exploration expenditure transfers (under section 45A and section 45B of the PRRTAA), and*
- *Starting base determinations.*

Taxpayers should consider the impact on project residual pricing methodology (if applicable).

State Taxes
Income Tax
Resource Rent Taxes
Transfer Pricing
Research and Development
Indirect Taxes
Sustainability and Climate Change
Tax Controversy
In this issue
Read more

MRRT repeal – Are you required to lodge?

On 20 November 2013, draft legislation for the repeal of the Minerals Resource Rent Tax (MRRT) was passed by the House of Representatives, and on 2 December 2013, the Senate Economic Legislation Committee report supported this repeal.

Under the proposed changes, the MRRT is to be repealed with general effect from 1 July 2014 for all MRRT taxpayers (including those with substituted accounting periods). The general application provisions are subject to a number of specific transitional provisions and integrity provisions to prevent the bringing forward of expenditure.

In addition to the MRRT repeal, the ATO have issued a legislative instrument providing certain taxpayers (i.e. for 'smaller miners' with <20 million tonnes per annum of production that did not make an MRRT instalment payment), with an automatic extension of time to lodge MRRT returns for the 2013 MRRT year until 1 December 2014. This applies for both June year end taxpayers and those with a substituted accounting period.

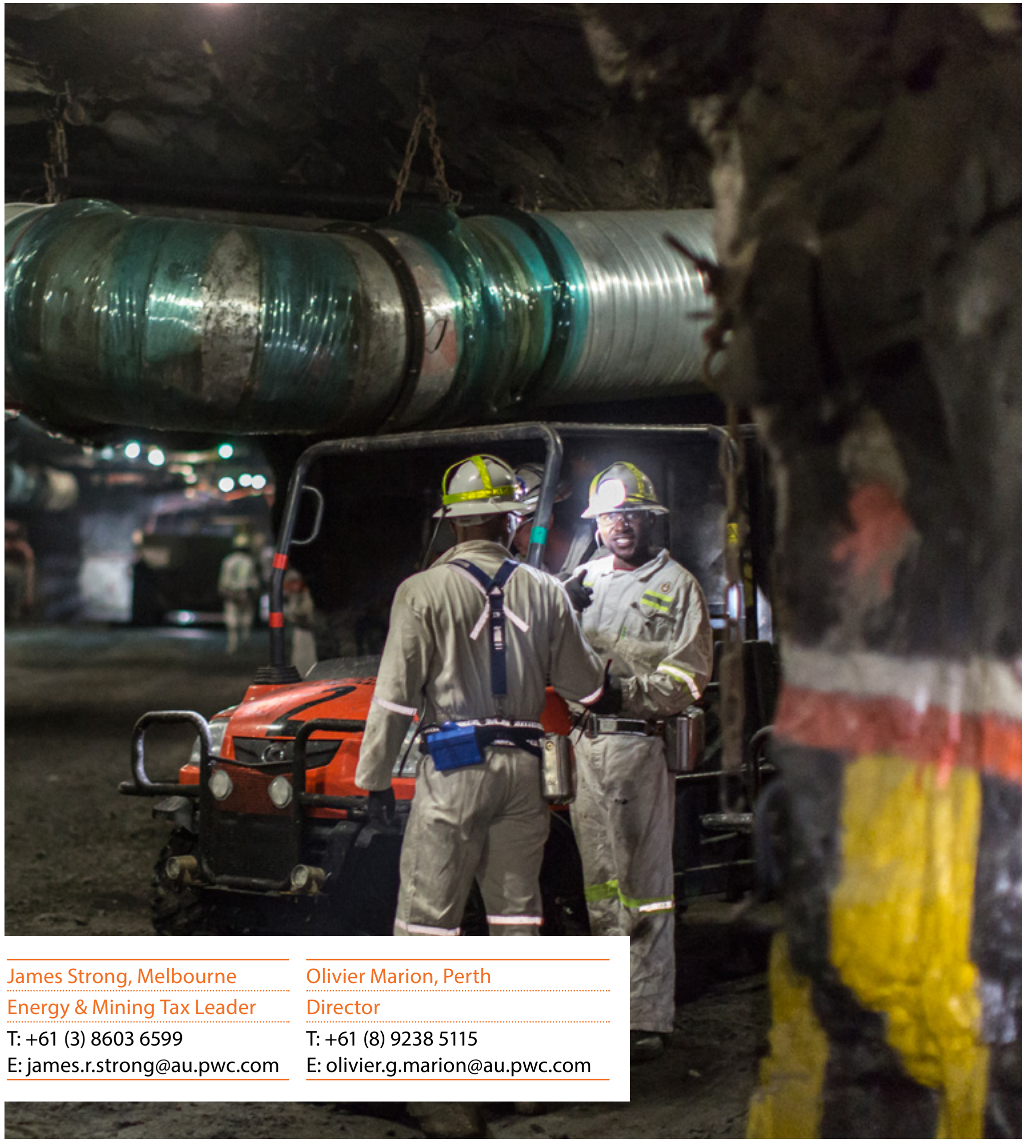
Whilst the MRRT repeal has the support of the Senate Economic Legislation Committee, the legislation still needs to go through the Senate itself, a process which could take some time. That said, miners are now preparing for life without MRRT.

The general effect of the repeal of the MRRT will be that taxpayers will not accrue/incur any further MRRT liabilities after 30 June 2014, and rehabilitation tax offsets will only be available in relation to years that end on or before 30 June 2014. However, the Commissioner of Taxation will continue to administer and exercise powers under the MRRT for those years in respect of which the MRRT has applied.

The repeal of the MRRT will result in coal seam gas (CSG) recovery becoming subject to the Petroleum Resource Rent Tax (PRRT) unless generally, the recovery is merely ancillary to coal extraction and the CSG is used in a manner prescribed in the legislation.

It appears the ATO are more focussed on the MRRT compliance of major iron ore and coal miners at this point in time. Whilst many of the 'smaller miners' (<20 million tonnes per annum miners) may be looking to take advantage of the extended due date for 2013 MRRT returns, this extension of time only applies if an MRRT instalment has not been made.

For tax accounting purposes, until the MRRT repeal is passed by the Senate, the MRRT repeal is not yet substantively enacted and there should not be any requirement for the MRRT repeal to be reflected in financial reports.



James Strong, Melbourne
Energy & Mining Tax Leader
T: +61 (3) 8603 6599
E: james.r.strong@au.pwc.com

Olivier Marion, Perth
Director
T: +61 (8) 9238 5115
E: olivier.g.marion@au.pwc.com

Transfer Pricing

New transfer pricing laws – Why resources companies should revisit their transfer pricing arrangements

New transfer pricing laws incorporated into the Income Tax Assessment Act 1997 (ITAA 1997) apply to income years commencing on or after 1 July 2013. From that date, the former transfer pricing provisions ceased to apply except in relation to earlier income years. The new provisions are in Subdivisions 815-B, 815-C and 815-D of the ITAA 1997.

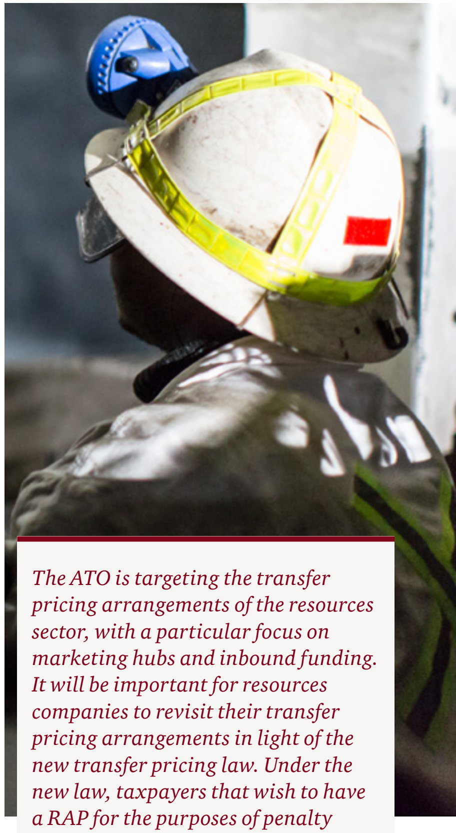
In summary, the new law:

- Ensures that the amount brought to tax in Australia by an entity operating a 'permanent establishment' is not less than it would be if the permanent establishment were a distinct and separate entity engaged in the same or comparable activities under the same or comparable circumstances, but dealing at arm's length with the other part of the entity.
- Introduces a requirement for taxpayers with 'cross border' activities to compare the 'actual conditions' relating to their commercial and financial relations, with the 'arm's length conditions' that would apply to those relations, and to treat the arm's length conditions as applying for income tax purposes where the actual conditions would otherwise result in a 'transfer pricing benefit'.
- Allows actual transactions to be **recharacterised** (i.e. disregarded and substituted with alternative financial or commercial arrangements) if the economic substance of the arrangements is not consistent with the legal form, or if arm's length parties would not have entered into the transactions as structured by the taxpayer.
- Contains special provisions to deal with the interaction of these new provisions with the thin capitalisation provisions in the ITAA 1997 to preserve the safe harbour concession even if the taxpayer could not have obtained debt at the level actually obtained if the taxpayer had been dealing at arm's length in obtaining its debt finance.
- Establishes a requirement to have transfer pricing documentation at the time of lodging a tax return, as a pre-condition to having a reasonably arguable position (RAP).
- Introduces a statute of limitations for transfer pricing adjustments of seven years (previously there was no statute of limitations).

In the May 2013 Federal Budget, the ATO was allocated $109.1 million to increase its compliance activities in relation to transfer pricing matters and the enforcement of these new transfer pricing provisions. Since enactment of these provisions the ATO has announced it will open 66 new cases of suspected tax avoidance by Australian and international companies through profit-shifting, of which it has stated 20 are likely to involve entities in the resources sector.

The impacts of the new transfer pricing law on the resources sector will include:

- **Marketing hubs:** The ATO has stated publically that it is specifically targeting offshore marketing hubs. The new law will require taxpayers to look beyond the transfer prices and consider issues such as whether the marketing hub actually performs the functions and assume the risks that have been assumed in setting the transfer prices, and whether arm's length parties would have structured the arrangements in that way.
- **Funding:** On cross border related party funding the new law will require taxpayers to look beyond the interest rate and consider whether the terms of the funding arrangement (or at least those terms which could influence the arm's length interest rate) are consistent with what would be expected between arm's length parties.
- **Comparable data for commodity pricing:** When setting transfer prices for products which have limited publicly available market pricing data (e.g. Liquefied natural gas and some minerals) the new law will require taxpayers to carefully consider what the relevant arm's length conditions are, e.g. is it simply the price of the product, or, if limited arm's length price data is available, does it also include the profits or profit margins of at least one of the parties to the transaction?



The ATO is targeting the transfer pricing arrangements of the resources sector, with a particular focus on marketing hubs and inbound funding. It will be important for resources companies to revisit their transfer pricing arrangements in light of the new transfer pricing law. Under the new law, taxpayers that wish to have a RAP for the purposes of penalty mitigation will need to prepare robust transfer pricing documentation.

Julian Hine, Melbourne
Partner
T: +61 (3) 8603 4899
E: julian.hine@au.pwc.com

Hamish McElwee, Perth
Principal
T: +61 (8) 9238 3571
E: hamish.j.mcelwee@au.pwc.com

Research and Development

Importance of contemporaneous evidence in R&D

The case of DBTL v Innovation Australia (2013) AATA 573 (DBTL), a recently published decision of the AAT, highlights to taxpayers the importance of maintaining contemporaneous evidence recording the commencement and progress of a research and development (R&D) activity.

In DBTL, the Applicant sought a review of Innovation Australia's determination that some of the activities carried out at the Applicant's open cut mine in the Hunter Valley, were not R&D activities under the former R&D tax concession. On review, the AAT held that none of the Applicant's claimed activities were R&D activities for the purposes of the concession.

DBTL is the first case to provide detailed guidance on the evidentiary requirements to prove the statutory elements of an 'R&D Activity'.

While the decision in DBTL was made in the context of the former R&D tax concession in the Income Tax Assessment Act 1936, the guidance and principles provided by the AAT hold true when considering the substantiation requirements under the new R&D tax offset in the Income Tax Assessment Act 1997.

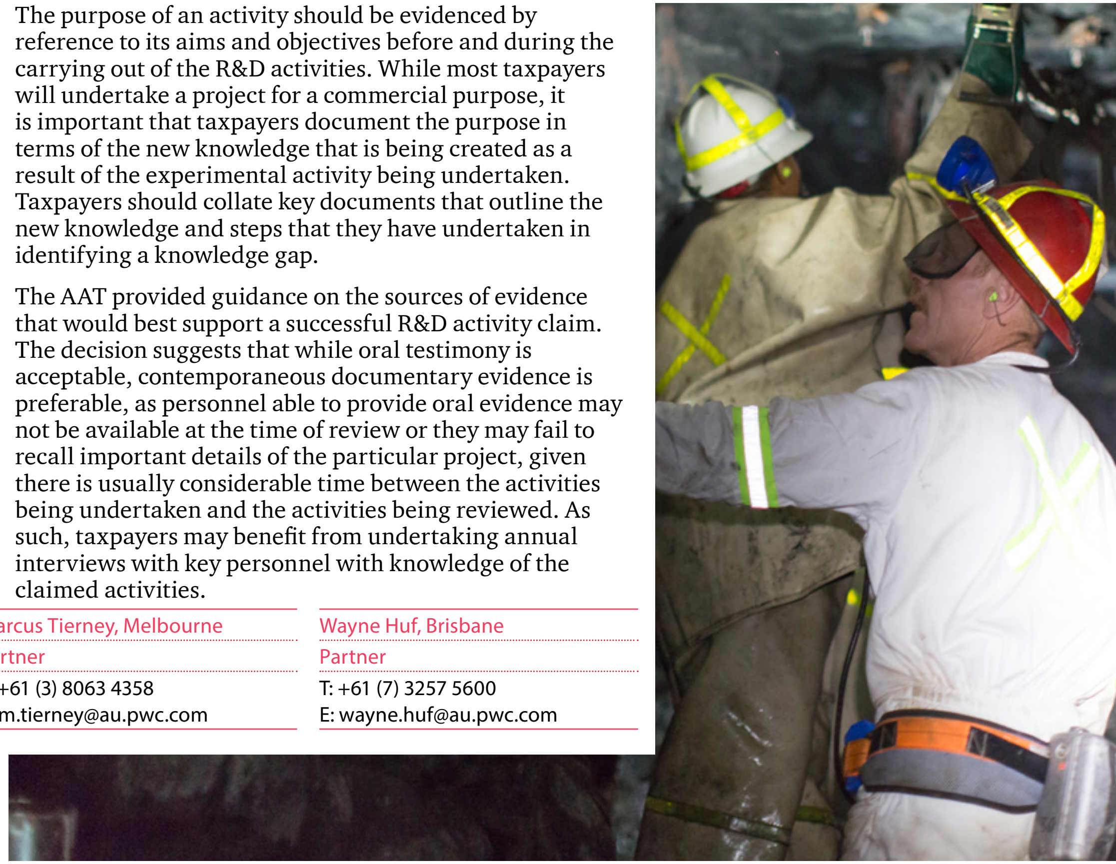
In light of the DBTL decision, here are some key tips that taxpayers should consider when making R&D claims:

- It is important to have a contemporaneously documented hypothesis to prove that the activity is 'experimental'. The hypothesis should be formulated and documented at the start of the R&D project and measured and tested throughout the life of the project. Evidence of a hypothesis may be contained in feasibility reports, proposals, board documents or annual reports prepared by experts engaged to advise on the activity.
- The purpose of an activity should be evidenced by reference to its aims and objectives before and during the carrying out of the R&D activities. While most taxpayers will undertake a project for a commercial purpose, it is important that taxpayers document the purpose in terms of the new knowledge that is being created as a result of the experimental activity being undertaken. Taxpayers should collate key documents that outline the new knowledge and steps that they have undertaken in identifying a knowledge gap.
- The AAT provided guidance on the sources of evidence that would best support a successful R&D activity claim. The decision suggests that while oral testimony is acceptable, contemporaneous documentary evidence is preferable, as personnel able to provide oral evidence may not be available at the time of review or they may fail to recall important details of the particular project, given there is usually considerable time between the activities being undertaken and the activities being reviewed. As such, taxpayers may benefit from undertaking annual interviews with key personnel with knowledge of the claimed activities.

DBTL provides some much needed guidance to taxpayers who intend to claim the R&D tax offset in respect of certain activities. Taxpayers are reminded of the importance of maintaining sufficient documentation that records the 'R&D purpose', hypothesis and conduct of the activities.

Marcus Tierney, Melbourne
Partner
T: +61 (3) 8063 4358
E: m.tierney@au.pwc.com

Wayne Huf, Brisbane
Partner
T: +61 (7) 3257 5600
E: wayne.huf@au.pwc.com



Indirect Taxes

Uncertainty continues to cloud GST and deferred 'farm-in' arrangements

Despite the release of Miscellaneous Taxation Ruling MT 2012/2, a great deal of uncertainty still exists in the market as to whether cash calls made under deferred 'farm-in' arrangements should be subject to the goods and services tax (GST).

Since the introduction of the GST, the ATO has had to wrestle with technical problems, mainly related to the timing of GST, which can arise on a strict interpretation of the GST law with respect to deferred 'farm-in' agreements. In an effort to ensure parity between participants in deferred 'farm-in' arrangements, and after significant lobbying by industry, the ATO sought to develop a 'work around' by issuing MT 2012/2. That Ruling was intended to, at long last, clarify the ATO's views on the GST implications of deferred 'farm-in' arrangements.

However, rather than providing clarity, some 18 months on from the release of MT 2012/2, significant uncertainty remains. This is principally due to the fact that MT 2012/2 focuses on the GST attribution of the deferred acquisition of the legal interest in the 'farm-in' arrangement and not the GST treatment of cash calls during the 'earn-in' period. As a result, if cash calls are subject to GST, there still remains significant uncertainty around when and how much GST is payable at any particular point in time during the 'earn-in' period. Much depends on the facts of each arrangement. There has also been inconsistency in positions taken by different advisors as to how GST applies to such arrangements.

Depending on the specific terms of the 'farm-in' agreement, it may be possible for the deferred 'farm-in' to constitute a GST joint venture (even prior to the 'farm-inee' taking a legal interest), in which case the question arises as to whether cash calls are outside the scope of GST. There is no ATO guidance on this point despite the prevalence of the use of joint ventures in the resources industry.

For the 'farm-inee', the issue is principally one of cash-flow and consistency of position from an ATO relationship management perspective (i.e. it is treating similar projects consistently for GST purposes).

However, there are also broader commercial impacts. For example, if cash calls are subject to GST and the 'earn-in' amount is stated in the agreement to be 'GST inclusive', then it is possible that the 'farm-inee' can reach its 'earn in' number and take an interest in the project by only committing 91 per cent or 10/11ths of its 'earn-in' commitments (i.e. if the 'earn in' is $22 million including GST, in real terms, the 'farm-inee' only needs to outlay $20 million to take the interest with the remaining $2 million that was paid being refundable as a GST input tax credit from the ATO).

Peter Konidaris, Melbourne
Partner
T: +61 (3) 8603 1168
E: peter.konidaris@au.pwc.com

Brady Dever, Melbourne
Director
T: +61 (3) 8603 4179
E: brady.dever@au.pwc.com

If you are a participant in an existing deferred 'farm-in' arrangement, you should review your circumstances to establish whether cash calls under the arrangement should be subject to GST and, if so, whether 'earn-in' commitments can be achieved on a GST-inclusive basis.

If you are contemplating entering into a deferred 'farm-in' arrangement, you should be aware of the varying GST consequences depending on the terms of each individual arrangement. Importantly, you should seek advice as to the most GST efficient means of participating in such arrangements from both a cash-flow and commercial perspective.

State Taxes
Income Tax
Resource Rent Taxes
Transfer Pricing
Research and Development
Indirect Taxes
Sustainability and Climate Change
Tax Controversy
In this issue
Read more

Optimising your Fuel Tax Credit refunds

The fuel tax credits (FTC) scheme offers credits (rebates) for the fuel tax included in fuel when used by businesses in particular activities. The scheme distinguishes between fuel used in 'on-road' transport by heavy vehicles and fuel used in other 'off road' uses, such as construction, mining and power generation. Fuel used in on-road transport receives the lowest rate (currently $0.12c per litre) while off road fuel receives a rate between $0.32c and $0.38c per litre).

The Linfox FTC case heard in the AAT (2012 AATA 517) continues to present significant opportunities for mining companies and mining service providers to lower fuel costs and recover overpaid excise. While the central tenet of the case related to refrigerated trailers, the ATO acknowledges the expanded eligibility to enhance FTC claims for other auxiliary equipment fixed onto heavy vehicles which travel on a public road.

In essence the outcome of the case is that fuel used to power auxiliary equipment (such as air conditioners, pumps and cranes) fixed on heavy vehicles can now be 'split out' from fuel used to propel the vehicle. The fuel used in these auxiliary components can be claimed at a higher FTC rate, being an extra $0.25 cents per litre. This has resulted in lower fuel costs for logistics/transport providers, with these companies able to retrospectively claim historic refunds for 4 years (and possibly more) as well as locking in 'go-forward' savings.

The ATO has recently released its 'safe-harbour' benchmark rates for specified activities which allow FTC claimants to use these rates when performing refund calculations. It is our view that the benchmark rates are appropriate for some activities, while conservative for others. Importantly for miners who use highly specialised vehicles with auxiliary equipment, the ATO's benchmark rates for such equipment is quite conservative relative to the analysis PwC has performed. Therefore there is significant value in conducting a detailed asset review to assess the extent to which FTC refund claims can be maximised.

Based on the ATO's benchmark rates, a mining company that spends $10 million per annum on fuel for a vacuum excavator (for example) would be entitled to an approximate refund/go-forward saving of $86,000 per annum (i.e. $350,000 over 4 years in refunds). However other approaches are available to claimants and we estimate a more detailed analysis could, depending on the circumstances, result in claims upwards of $345,000 per annum ($1.4 million back over 4 years) for such a vehicle.

The value and opportunity for mining clients will depend on what services are outsourced and how current contracts contemplate fuel spend, FTC entitlement/pass-through and any related rebates or reductions based on change in law. It will also depend on what calculation methods are used to determine a refund amount.

Brady Dever, Melbourne
Director
T: +61 (3) 8603 4179
E: brady.dever@au.pwc.com

Bill Cole, Melbourne
Director
T: +61 (3) 8603 6043
E: bill.cole@au.pwc.com

Government simplifies offshore petroleum registration fees and proposes cash bidding for titles

Offshore petroleum registration fees are effectively abolished and a cash bidding system is to be introduced.

Participants in the Australian oil and gas industry should be aware of two recent developments relating to offshore petroleum titles.

Changes to offshore petroleum registration fees

- All applications made on or after 1 November 2013 for approval and registration of transfers or dealings relating to Commonwealth offshore petroleum titles will now be subject to fixed application fees.
- Prior to 1 November 2013, the Commonwealth imposed registration fees at a rate of 1.5% on the transfer of, and dealings in, petroleum titles (on the greater of the consideration provided or market value of the interest).
- Under the new regime, a flat fee of $7,180 will be payable on an application for approval of a transfer of a title under the Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth) (OPGGSA). An application for approval of a dealing in a title under the OPGGSA will attract a flat fee of only $2,950.
- Applications made up to 31 October 2013 will be subject to the former registration fees. However, delayed lodgement to take advantage of these changes will not be considered a valid reason for late lodgement.

Cash bidding system for offshore petroleum titles

- At the time of writing, a bill was before the House of Representatives which will introduce a cash bidding title allocation method for select blocks included in the 2014 Offshore Petroleum Exploration Acreage Release.
- Under a competitive cash bidding system, applicants offer cash bids for the right to explore, with exploration permits being awarded to the highest cash bidder. Permit holders have the exclusive right to apply for production licence if a resource is discovered.
- Key features of the competitive cash bidding system are as follows:
  - The discretion to refuse an offer of a permit from the Commonwealth will be limited
  - A reserve price will be set by the Joint Authority which may be either disclosed or undisclosed
  - Separate pre-qualification and bidding processes to allow for an assessment of the potential bidders will be made prior to placing cash bids, and
  - A tie-breaker mechanism will address circumstances where two or more cash bids are equal.

Matt Budge, Perth
Partner
T: +61 (8) 9238 3382
E: matthew.budge@au.pwc.com

Sara Mattsson, Perth
Director
T: +61 (8) 9238 3671
E: sara.e.mattsson@au.pwc.com

The change to offshore petroleum registration fees is a very positive development as it will substantially lower the registration fees payable within 90 days of acquiring an interest in offshore petroleum titles. It is similarly good news for any oil and gas companies looking to restructure their petroleum title holdings. There was a concession in the previous registration fee legislation for genuine restructures, but the fees payable under the new flat rate simplify the process and remove uncertainty regarding the quantification of the registration fees payable.

As the cash bidding system is targeted at mature areas (or those known to contain petroleum accumulations) it may introduce some economic efficiencies. However the new system is likely to face criticism by industry participants as it potentially diverts funds from exploration activities. It will be interesting to monitor the implementation of the system to ascertain if equitable outcomes are obtained and the degree to which disclosures are made by the Commonwealth.

Sustainability and Climate Change

Repeal of the carbon tax – Where to now?

The Bill to repeal the Federal Government's Carbon Price (the bill) was recently passed by the House of Representatives and, at the time of writing, had moved to the Senate. While the composition of the Senate and statements made by the Labor and Greens Senators against the repeal Bill suggest that the Bill is unlikely to be enacted prior to 1 July 2014, a number of developments should be monitored by affected businesses during the interim time period.

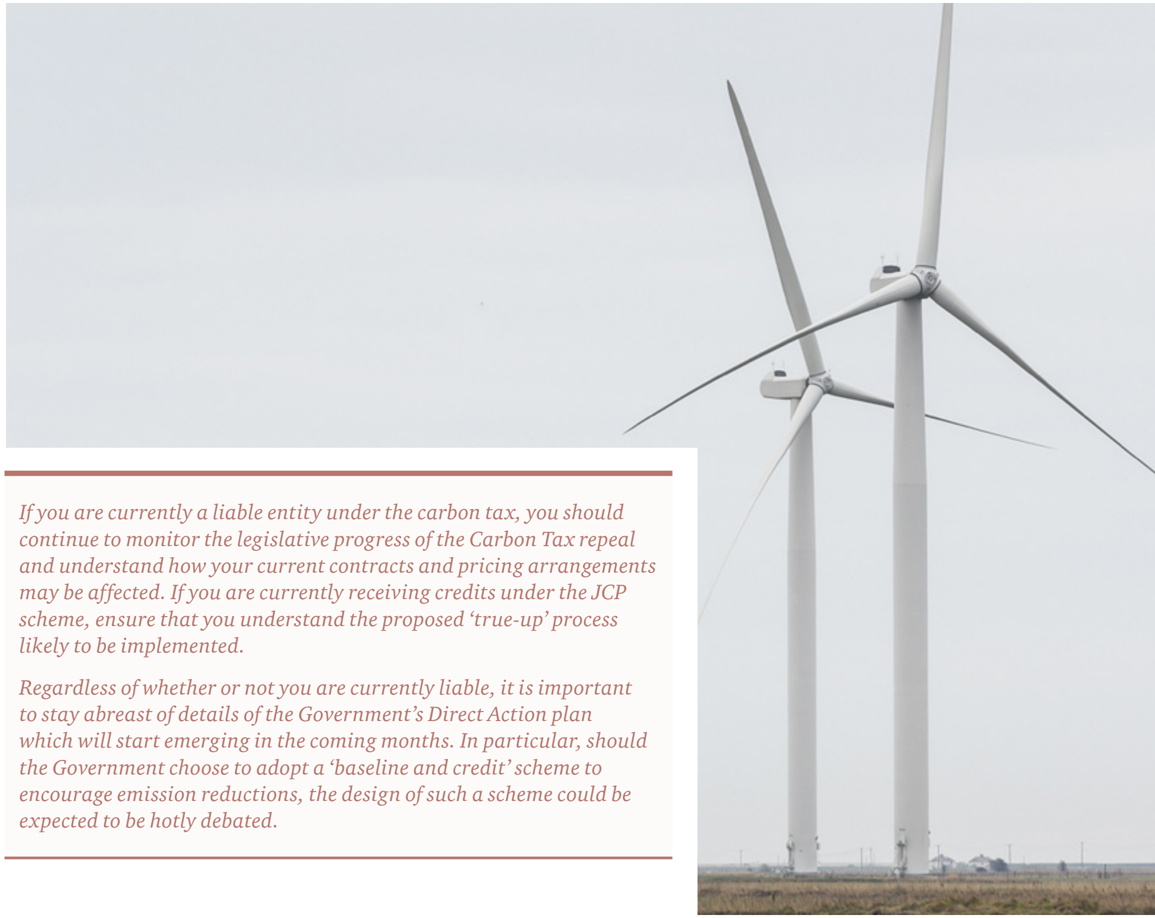
The current legislation proposes to abolish the Carbon Price, as well as the Climate Change Authority and the Clean Energy Finance Commission. Separate legislation will then be drafted to create the Emissions Reduction Fund and the Direct Action Plan.

It is currently proposed that even if repealed, the Carbon Price will continue through to the end of the 2014 financial year, with interim reporting being required on 15 June 2014 and final submission of credits being due by 2 February 2015.

It is also proposed that industry assistance that was provided under the Jobs and Competitiveness Program (JCP) will cease at the end of the 2014 financial year. At that time, a 'true-up' will occur, to account for the under-allocation and over-allocation of free carbon units.

At the time of writing, the Green Paper for the Emission Reduction Fund was soon to be released (in December 2013), with the White Paper being released in early 2014. The timing around the release of the Green Paper leaves a limited timeframe for public consultation and should be monitored closely by affected parties.

John Tomac, Sydney
Partner
T: +61 (2) 8266 1330
E: john.tomac@au.pwc.com



If you are currently a liable entity under the carbon tax, you should continue to monitor the legislative progress of the Carbon Tax repeal and understand how your current contracts and pricing arrangements may be affected. If you are currently receiving credits under the JCP scheme, ensure that you understand the proposed 'true-up' process likely to be implemented.

Regardless of whether or not you are currently liable, it is important to stay abreast of details of the Government's Direct Action plan which will start emerging in the coming months. In particular, should the Government choose to adopt a 'baseline and credit' scheme to encourage emission reductions, the design of such a scheme could be expected to be hotly debated.

Tax Controversy
Commissioner releases new access guidelines

On 6 November 2013, the ATO released a revised version of their Access and Information Gathering Manual. The publication, now known as 'Our approach to information gathering' ('the Guide'), seeks to provide a user friendly guide to the Commissioner's formal and informal information gathering processes and powers.

There are a number of key themes arising from the ATO's revised information gathering Guide. Firstly, whilst the Commissioner has continued to emphasise his preference for a cooperative approach and the use of informal powers, he has listed a set of circumstances that appear to give the ATO more flexibility in the use of his formal powers. The expanded bases refer to the use of formal powers where:

- there is a risk to revenue collection
- there is a litigation risk for the ATO
- there are high risk issues
- there are international issues and complex structures
- there is voluminous evidence, or
- the ATO seeks to efficiently use its resources when gathering information.

This is a departure from the previous approach where the Commissioner typically only used his formal powers in circumstances where there was a breakdown in taxpayer communication or where there was application of anti-avoidance rules. It is consistent with recent statements by the Commissioner concerning the flexibility to invoke his formal powers in cases involving multi-nationals. This change is brought about by the recent focus by the Commissioner on the efficient use of resources by the ATO. Accordingly, ATO officers are now more likely to issue formal notices and requests requiring the production of documents or access to premises to ensure that a matter progresses expeditiously. The Commissioner's intent in reducing time frames is particularly relevant to taxpayers within the mining industry, where matters frequently involve extensive documentary material and contemporary evidence.

The revised Guide signals a definite shift in approach on the part of the Commissioner concerning the expanded bases for the use of his formal information gathering powers. Accordingly, it is important that taxpayers are aware of their rights and their responsibilities and seek appropriate advice in responding to formal production notices, notice to attend interviews and access requests. It is also important that taxpayers manage their relationships and interactions with the ATO to ensure that the Commissioner continues to use formal approaches as a last resort.

Secondly, the Commissioner has increased his focus on international tax issues and has indicated that he will use the full extent of his domestic and international information gathering process to obtain information. This includes the use of offshore information notices in situations where the Commissioner believes information or documents relevant to the assessment of a taxpayer are held outside of Australia. In the event that the requested information or documents are not provided, taxpayers may not be able to subsequently produce documents or information to support their position for the purposes of litigation. The Commissioner will use these powers in addition to his continued use of existing information exchange avenues with foreign tax jurisdictions including Tax Information Exchange Agreements ("TIEA"), and the ATO's participation in the Joint International Tax Shelter Information Centre ("JITIC") and Joint Audit programs.

Thirdly, taxpayers are now encouraged to provide information electronically for the purposes of increasing efficiency. This is supplemented by the development of the ATO's bulk data exchange.

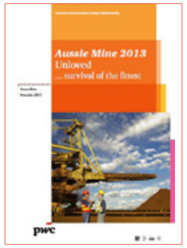
Michael Bersten, Sydney
Patner
T: + 61 (2) 8266 6858
E: michael.bersten@au.pwc.com

Paul McCartin, Melbourne
Director
T: +61 (3) 8603 5609
E: paul.mccartin@au.pwc.com

Read more

Aussie Mine 2013 – Unloved … survival of the fittest

In its 7th year, Aussie Mine provides an industry and financial analysis of the largest 50 mining companies listed on the ASX with a market capitalisation of less than $5 billion at 30 June 2013 (the mid-tier 50).



Mine 2013: A Confidence Crisis

The global mining industry is facing a crisis in confidence, ending years of outperformance and superior returns according to PwC's 10th annual global mining report, Mine: A Confidence Crisis.

Productivity, not Austerity

Our new productivity scorecard for the mining sector.

Deals in the dumps

Global Mining Deals: 2013 Mid-year report.

Mining for Talent

A study of women on boards in the mining industry.

Protecting prosperity: Why we need to talk about tax

Launched on 23 July, this publication looks at the long term future of Australia's economy and the need for comprehensive tax reform.