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Multi-Client Seismic Data
Submission on behalf of the International Association of Geophysical Contractors

Dear Kenneth,

Thank you for the opportunity to comment on the proposed draft *Taxation Determination TD 2017/D[3840]: Income tax: does expenditure incurred by a service provider in collecting and processing non-exclusive (multi-client) seismic data constitute the cost of a depreciation asset under Subdivision 40-C of the Income Tax Assessment Act 1997?*

We also thank the Australian Taxation Office **(ATO)** for the time it has invested in consultation with the International Association of Geophysical Contractors **(IAGC)** prior to the release of the proposed draft Tax Determination.

This submission has been prepared on behalf of IAGC and its members as key participants in the multi-client seismic data industry. The IAGC has consulted with its members to ensure the submission reflects industry practice and its concerns regarding the ATO's proposed view of the taxation of multi-client seismic data.

All legislative references in this submission are to the *Income Tax Assessment Act 1997* unless otherwise stated.

Policy issues

The IAGC is of the opinion that the tax treatment outlined in the proposed draft Taxation Determination creates a number of policy issues, including:

- A significant divergence between the commercial reality and the tax outcomes;
- A mis-match between the revenue timing, which occurs primarily prior to finalising the multi-client activities (i.e. via pre-funding) and in the immediate period after undertaking the activities (i.e. years 1 to 5) as compared to a statutory 15 year tax amortisation period; and
- That the impact of the proposed draft Tax Determination will be to discourage Australian exploration via the multi-client business model by increasing the cost of these activities to Australian E&P companies. This is potentially poignant in the current environment whereby the IAGC is of the view that exploration for the sourcing of new energy projects should be encouraged.

In our meeting on 8 September 2017, you indicated that these policy matters are not within the ATO's area of responsibility. That said, for the reasons expressed below, it is the view of the IAGC that the existing tax law can be appropriately interpreted to overcome these policy issues.

Issues addressed in this submission

The manner in which the amendments to the tax law dealing with the treatment of mining, quarrying and prospecting information held on or after 7:30pm AEST on 14 May 2013 has been applied by the ATO to the multi-client seismic industry in the proposed draft Taxation Determination has significant importance to the industry, particularly given the quantum of expenditure incurred by participants on undertaking surveys, collecting and processing the data.

These tax amendments, which provide a statutory life of 15 years for the effective life of the mining, quarrying and prospecting information **(MQPI)** created by a taxpayer that does not otherwise relate to a specific mine or field (or proposed mine or field) were introduced in response to integrity concerns that immediate deductions were being claimed for the cost of acquiring mining rights and information where the price paid reflected the value of resources that had already been discovered.[1]

However, the application of these tax law changes to the multi-client seismic industry, and in particular, that the cost of expenditure to undertaken surveys, collect and process the data is capital in nature and required to be written off over 15 years affects the long standing tax practices taken by the majority of participants in the industry (depending upon their individual facts and circumstances) that these costs can be incurred on revenue account.

Whilst the IAGC appreciates that the ATO considers the proposed draft Taxation Determination is relevant in dealing with a singular issue that is specific to taxpayers in a particular industry, as a general comment, the IAGC submits that the short form Taxation Determination is not an appropriate form as it does not provide sufficient scope to deal with the specific individual features of the industry's multi-client activities and the technical complexity outlined in further detail below.

Specifically, the IAGC submits that the proposed draft Taxation Determination promotes the ATO's view based on limited consultation with individual industry participants, a fact pattern that does not reflect the commercial and business practicalities of the industry and it's exploitation of the multi-client data. Given the form chosen, the ATO has not provided a detailed technical analysis of the revenue/capital distinction of the expenditure, analysis of alternative views or sufficient examples that would acknowledge the degree of variability to business practices within the industry that are relevant to the tax treatment of expenditure incurred. As such, the IAGC submits that the proposed draft Taxation Determination in its current form does not provide adequate or meaningful guidance to the industry as compared with other guidance issued by the ATO (for example, the detailed *Taxation Ruling TR 201711: Income tax: deductions for mining and petroleum exploration expenditure* which provides a comprehensive analysis of the application of section 8-1 for expenditure incurred by mining and exploration companies).

The IAGC also disagrees with the technical conclusions adopted by the ATO in the proposed draft Taxation Determination. The IAGC submits the following specific matters on behalf of its members:

Submission Point 1:	The Geophysical Services Provider in many instances incurs the expenditure in undertaking multi-client surveys on revenue account and therefore such expenditure should be deductible under section 8-1.

Without prejudicing the industry's primary view that the expenditure can be incurred on revenue account, the IAGC submits that:

Submission Point 2:	If the expenditure is considered to be capital and to form part of the cost of a depreciating asset, then the expenditure can be immediately deductible under section 40-80.

[1] Explanatory memorandum to the Tax and Superannuation Laws Amendment (2014 Measures No.3) Bill 2014 and Superannuation Laws Amendment (2014 Measures No.3) Act 2014.

Submission Point 3:	If the expenditure is considered to be capital and to form part of the cost of a depreciating asset, the final Taxation Determination must address the manner and nature in which a balancing adjustment event occurs and a balancing adjustment can subsequently be claimed.

Each of these submission points are discussed in turn below.

Specific comments on each submission matter

Submission Point 1:	**The Geophysical Services Provider in many instances incurs the expenditure in undertaking multi-client surveys on revenue account and therefore the expenditure should be deductible under section 8-1.**

The non-exclusive (multi-client) geophysical data licensing business model emerged in the 1980's as a means to provide parties, including governments, E&P Companies and Geophysical Service Providers an alternative and/or complementary business model to maximise the discovery and ultimately the exploitation of hydrocarbons. In particular this business model facilitates a lower cost for each user of the data by spreading the cost over multiple parties. The practical effect of the business model for non-exclusive (multi-client) geophysical data is that takes advantage of the economies of scale of the industry by spreading the costs of data acquisition and processing among multiple customers who desire to make use of the data.

While the cost of the data can be spread over multiple parties, the inherent nature of the customer profile and industry provides for a limited number of potential customers with a limited window in which to exploit the data. Under this model the Geophysical Services Company initiates and conducts projects of general industry interest by sharing financial and technical risk. Multi-client seismic surveys are increasingly becoming part of the core business of the majority of seismic industry contractors. Most companies conduct multiple multi-client surveys each year, moving from one country to another, following the short term exploration demands of the E&P Companies.

The IAGC notes the proposed draft Taxation Determination has been prepared by the ATO based on the standard terms used to describe multi-client surveys, being that the Geophysical Services Provider owns the data and licences it to an E&P Company end user over many years (i.e. the Example in the proposed draft Taxation Determination uses a period of 25 years[2]). There is a presumption by the ATO that the fact that the Geophysical Service Provider has a proprietary interest in the information results in the expenditure incurred by the Geophysical Company being capital and thereby forming part of the cost of a depreciating asset in the form of MPQI.

Although the IAGC confirms that the Geophysical Services Provider can retain a proprietary interest in information and enters into restricted data licenses with individual E&P Companies, the industry submits that the practical, business and economic effect of the transaction is that, it is essentially the *sale of data* with restrictions such that:

- The Geophysical Services company can continue to monetise the data to other participants; and
- The E&P company that acquires the information cannot on-sell or otherwise deal with it.

Further, the typical business model for undertaking multi-client activities will have the following features:

- In order to make an investment decision most surveys will require a significant level of pre-funding to be secured prior to the completion of the vessel operations. This is estimated to be in the range of 70% to 100% of costs.

[2] The IAGC notes that although the restricted period may be up to 25 years in a particular licence in practice the information is restricted only for a maximum of 15 years in Australia given that the data is released by GeoScience pursuant to the Petroleum Act after 15 years.

- The internal decision making and approval process to undertake the multi-client shoot is focussed on short term data sales in years 1 to 5 following the shoot. There is a limited or no expectation of subsequent data sales beyond the 5 year period when making the decision to undertake the activity.

The contractual terms of multi-client activities undertaken under a Special Prospecting Authority **(SPA)** can be the subject of negotiation between the Geophysical Services Provider and clients. As discussed in our meeting on 8 September 2017, multi-client activities can and have been undertaken such that they are in substance akin to a traditional proprietary model.

The nature of the business model is also not dissimilar to that of certain software licence providers whereby the rights acquired by the user for the program under the licence are limited to those necessary to enable the user to operate the program. This concept of "simple use" is acknowledged and understood by the ATO and recognised as giving rise to different tax outcomes for both the licensor and licensee.[3]

There will also be circumstances where the tax characterisation of such payments is that of a services payment (i.e. general income received by the licensor through the use of the software or intellectual property) rather than a royalty or licence of an intellectual property asset.[4]

Therefore, it is submitted that the actual practical and business effect of the multi-client model is that in most cases the Geophysical Services Provider continues to provide exploration information under a *variation* to the original proprietary or exclusive acquisition model (under which expenditure is accepted to be deductible under section 8-1). Therefore the expenditure incurred under a multi-client model should also continue to be treated as being on revenue account.

The IAGC specifically notes that in our meeting with the ATO on 8 September 2017, the ATO representatives acknowledged that if a survey undertaken under a multi-client model is then licenced to a single E&P company such that it mirrors an exclusive use type services contract, then the expenditure could be treated as deductible on revenue account, despite its (arguable) legal form.

It therefore follows that if the multi-client survey is fully pre-funded by the users of the multi-client data resulting in a significant portion of the data and information being pre-sold, prior to expenditure being incurred, then the expenditure should also be treated as akin to that of a sub-contractor arrangement and immediately deductible under section 8-1. In this respect, the IAGC notes that in many cases, multi-client surveys are typically pre-funded by between 70% and 100%[5] prior to the work in progress period being completed.

Importantly, it is noted that the proposed draft Taxation Determination provides only 6 short paragraphs (para 15 to 21) on the technical interpretation of whether the expenditure is of a revenue or capital nature, most of which are limited to singular case law quotes.

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[3] See the ATOs ruling, TR 93/12 - Income tax: computer software

[4] Refer to the Commentary on the OECD Model Tax Convention on Income and on Capital (2014), Commentary on Article 12, paragraphs 12-15.

5 Outliers on each side of this range will occur depending on the business model assumed by the Geophysical Services Provider.

The IAGC therefore submits that the analysis is of insufficient detail to deal with the application of the revenue/capital distinction and is flawed for the following reasons:

- At paragraph 15, the ATO quotes *Sun Newspapers & Anor v Federal Commissioner of Taxation* and in particular the case law judgement that the classification of expenditure is based upon whether it relates to the "business entity, structure or organisation set up", or the way in which the "organisation operates to obtain regular returns by means of regular outlay". The IAGC submits that the collection of data by many Geophysical Services Provider under the multi-client business model is a recurring expense and is part of the ongoing process of carrying on a business to obtain regular returns by means of regular outlays.

  The business model does not of itself, enhance or alter the overall profit making structure of the company. In particular, and both globally and within Australia, the Geophysical Services Provider relies on predictable and recurring lease/licencing rounds by governments to plan and execute seismic projects based on acreage that will be made available for leasing or licencing. These surveys are undertaken as part of an ongoing business. The repetitive process of sourcing, processing and licensing data leads to the conclusion that the amount is paid out of circulating capital and therefore revenue in nature.

- At paragraph 16, the ATO quotes *Hallstroms Pty Ltd v Federal Commissioner of Taxation* and specifically, that whether an outgoing is on revenue or capital account depends on the effect of the expenditure "from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any..." The IAGC submits that the ATO has had regard only to the juristic classification of the contract, being that it is a licence and that the Geophysical Service Company retains legal ownership of the data.

  The IAGC submits that the actual practical and business effect of the multi-client model is that the Geophysical Services Provider continues to provide a service under a *variation* to the original proprietary or exclusive acquisition model. That is, the company is working within its existing structure (albeit under a different operating model) to derive income from the provision of seismic products and services to clients and therefore the expenditure incurred should continue to be treated as on revenue account and deductible under section 8-1.

- At paragraph 17, the ATO quotes *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* and that the classification of expenditure as revenue or capital, is dependent upon the "character of the advantage sought". The IAGC submits that the advantage sought by incurring the expenditure is for the Geophysical Services Provider to be able to conduct its ordinary, repetitive and continual business activities of acquiring, developing and licensing seismic data.

  It is the intention of the Geophysical Services Provider to collect and licence as much data as possible and to have multiple projects in any given year as well as future years to derive regular income returns. Given that the majority of surveys are only completed where there is either a significant amount of pre-funding or a business expectation that costs will be recovered within the work in progress period or shortly thereafter, the advantage sought is the continued operation of the business.

- At paragraph 18 the ATO quotes *British Insulated and Helsby Cables Ltd v Atherton* which provides that where the expenditure is made "with a view to bringing into existence an asset or advantage for the enduring benefit of a trade" that the expenditure should be capital in nature. While the IAGC does not dispute that the expenditure on a multi-client data survey brings into existence a legal asset that is of value and can therefore be monetised, the IAGC submits that the creation of the data does not necessarily result of itself in the expenditure being on capital account. In particular, as outlined in TR 2017/1 at paragraph 17 the ATO specifically recognises:

  > *"Case law also established that expenditure which produces an enduring or lasting benefit or advantage may be regarded as capital in nature. However, the mere fact that some property right may emerge from the expenditure is not enough to make it capital."*

And further at paragraph's 19 and 23 of TR 2017/1, the ATO state that:

> *"Expenditure on EFS will have the hallmarks of* a *revenue outgoing in* a *mining business where undertaking such evaluative studies is part and parcel of the ongoing process by which the business operates 'to obtain regular returns by means of regular outlays'. This also applies to 'how to mine' investigations that are fundamental inputs to such EFS. [emphasis added]*
>
> *and*
>
> *The mere fact that expenditure produces "information" is not enough to stamp the expenditure with* a *capital nature because in knowledge there is an "enduring benefit". Otherwise, there would effectively be* a *presumption that all exploration expenditure* was *on capital account."*

Industry further submits that while the information may have some short term benefits (i.e. 1 to 5 years), it cannot be regarded as having an enduring capital benefit for the following reasons:

a) The multi-client model is focused on near term revenues and pre-funding. Most projects are cash-flow positive in the very short term or during the work in progress period, with a very high percentage (the vast majority) of total project life revenues derived in the work in progress period. Subsequent year revenues are significantly discounted in the initial investment analysis approval stages. Typically the investment analysis is projected on the basis that no revenue is generated post 5 years after survey completion.

   The limited value life cycle of the data is evidenced by the general amortisation period of the expenditure for accounting purposes of 4 years and the significant impairments that are otherwise required over that period under accounting standards for assets capitalised to a multi-client data library. Therefore while contractual terms may technically provide for a period of restriction of 25 years (limited to 15 by statute), the economic reality is that the data has negligible value after a much shorter period (i.e. 4 years).

b) The revenues anticipated to be derived are high risk and highly contingent. Facts such as technology, energy prices, future exploration budgets and uncertainty of future energy mix are all relevant considerations in this regard.

c) Exclusivity cannot necessarily be maintained given that the Special Prospecting Authority does not grant exclusive rights to the area where an acreage is granted and where the survey is undertaken. If an E&P Company were to apply for a licence or exploration permit over the area of the survey, the ability of the Geophysical Service Provider to further commercially monetise the asset would be diminished, given that the area would be no longer available to other E&P companies. In addition, several multi-client surveys can be shot over the same area by competing multi-client companies at different times and using different technologies

In view of the above, the data cannot be said to be an asset of enduring benefit.

Furthermore, the IAGC submits that in considering the nature of expenditure incurred to develop and licence the seismic data, there are a number of specific Australian cases that have not been addressed by the ATO. These cases specifically deal with expenditure of a similar nature, that is, expenditure that gives rise to a proprietary right or restriction under a licence, but which is treated as revenue in nature. These include:

1. BP Australia Limited v FC of T (1965)

The BP Australia case provides precedent that expenditure incurred in the regular conduct of business should be treated as on revenue account. In BP Australia the taxpayer entered into exclusive dealing arrangements in relation to the sites through which its products could be sold to the public. Under the agreements, the taxpayer agreed to pay lump sum amounts as consideration to service station operators undertaking to sell exclusively the taxpayer's brand of petrol for a fixed number of years, between 3 and 15 years. The Privy Council overturned the decision of the majority of the High Court in BP Australia Limited v FC of T and held these payments to have been made on revenue account. The Privy Council considered the advantage sought by the taxpayer to be:

> *"The advantage which BP sought was to promote sales and obtain orders for petrol by up-to-date marketing methods, the only methods which could now prevail. Since orders were now and would in future be only obtainable from tied retailers, it must obtain ties with retailers. Its real objective however was not the tie but the orders that would flow from the tie.…the payment of such sums became the regular conduct of the business... [emphasis added]*

In applying this case, the IAGC disagrees with verbal comments made by the ATO in its meeting on 8 September 2017 that this case is distinguishable. In particular, it is noted that the adoption of the multi-client model by industry members is similarly an "up to date" marketing method and the payment of expenditure to collect the data is a regular conduct of businesses in this industry, notwithstanding that it has what may in some cases be considered capital features. In particular, the IAGC submits that the potential licence fee does not represent a return received on fixed capital of the Geophysical Services Provider and rather it represents an amount which comes back to company as part of its regular, ongoing business of collecting, processing and licensing seismic data i.e. it forms part of the business circulating capital.

2. National Australia Bank Limited v FC of T

In the *National Australia Bank* case, the taxpayer made a bid to secure the exclusive right to act as the lender under a Commonwealth defence force housing loan assistance scheme for a "franchise period" of 15 years. The taxpayer's bid was successful and an agreement was consequently entered into, which required the taxpayer to pay the Commonwealth an up-front $42 million payment (although the taxpayer wished to make annual payments) plus an annual amount based on a formula where the number of loans exceeded the prescribed minimum numbers. The taxpayer argued and was successful in the Full Federal Court that the expenditure was consistent with its current business of "segment marketing", where money was expended on marketing to a segment of the market considered to be a worthwhile source of profitable customers. The decision of the Full Court of the Federal Court turned on a consideration of what was the character of the advantage sought by the bank:

> *"…from a practical and business point of view what the Bank sought to achieve by the payment was the expansion of its home Joan customer base…*
>
> *…an inquiry as to whether what the Bank acquired under the agreement was in the nature of a monopoly obscures what in our view is the real question – what was the ultimate advantage sought by the making of the payment? The answer, from a practical and business point of view, is that the Bank was hoping to sell more home loans and make a profit out of the interest derived from them…"*

Again, the IAGC submits that notwithstanding the proprietary nature of the data, from a practical and business point of view, the effect of the expenditure incurred by the Geophysical Service Provider is to secure sales of the data to multiple E&P companies. This approach is explicitly (and correctly in our opinion) recognised by the ATO in TR 2017/1 – see paragraphs 217 – 221 for a detailed discussion.

The surveys, collection and processing of the data itself is part of the normal operating conduct of the business and as supported by the NAB case, any restrictions on the sale or monopolistic rights the Geophysical Service Provider retains over the data does not of itself change the character of the advantage sought by the Geophysical Services Provided, being to undertake ordinary business activities.

3. FC of T v. Ampol Exploration Limited

In the Ampol Exploration case, the taxpayer had been engaged for many years in the business of exploration for petroleum in Australia both on land and in offshore waters. Often the actual work of exploration or production was done by operators appointed by the taxpayer but in other cases the taxpayer had undertaken the exploration activities itself. During the 1979 year the taxpayer entered into agreements with the Chinese government to participate in geographical surveys of offshore China in order to discover possible oil and gas fields. The effect of participating at this stage was that the taxpayer would be entitled to bid on a competitive basis for participation in the next stage which involved the exploration and development of any fields discovered in the geographical surveys.

The taxpayer used certain companies within the Ampol group as a joint venture vehicle in respect to the Chinese activities and assigned its interest in the agreements with the Chinese to the joint venture company. The consideration payable for the assignment was to be a sum as agreed upon or the taxpayer's costs relating to the geographical surveys plus 15%. The geographical surveys were actually undertaken by one of the participating oil companies and all other participating oil companies, including the taxpayer, were required to share the costs in return for receiving copies of the survey results.

The taxpayer claimed a deduction for the costs it had incurred in respect to the geographical surveys. It was held by the Full Federal Court that the expenditure was deductible under either of the limbs of section 51(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) (the predecessor to section 8-1) and that the expenditure was also not of a capital nature to prevent it being deductible. In particular, the court stated

> *"From a practical and business point of view the taxpayer sought to adopt one of a number of possible methods in which it engaged for the purpose of its exploration business to obtain, if all went well, the possibility of a right to bid to further undertake further seismic and exploration work."*
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> *"The payments in question were in truth part of the outgoings of the taxpayer in the course of carrying on its ordinary business activities. It was not expenditure incurred for the purpose of creating or enlarging a business structure or profit-yielding or income producing asset."*
>
> *"The advantage sought by the expenditure was the opportunity to pursue in China exploration of the kind normally pursued by the company in and near Australia, with a view to the rewards the exploration might bring, including such a fee as that in respect of which ultimately a minimum was fixed, though sec. 51 does not require that an anticipated reward be of so direct a nature…"[emphasis added}*

4. Goodman Fielder Wattie Ltd v FC of T

In Goodman Fielder Wattie v FC of T 91 ATC 4,439 (Goodman), the taxpayer was a company which carried on business in a number of divisions. The taxpayer entered into an agreement with the Queensland Institute of Technology to establish a research and development centre for the production of monoclonal antibodies and related products suitable for commercial development. The taxpayer claimed deductions for its contribution to the centre and for expenditure incurred by one of the divisions of the taxpayer on manufacturing, administration and research and development under section 51(1) of the ITAA 1936, or as expenditure of a capital nature on scientific research under section 73A(1) of the ITAA 1936.

The Court found that up until the point the taxpayer was carrying on the business, any expenditure incurred by the taxpayer was not deductible. However, the expenditure incurred after the establishment of the business of research and development was held to be deductible under either of the above mentioned sections.

Hill J in his judgement stated:

> *"There is in my opinion, much to be said for the view that the whole of the expenditure in issue in the present case...*was *expenditure on revenue account rather than on capital account. A company engaged in an enterprise involving new technology such as the applicant, where the nature of its activities requires* as *part of its business ongoing research into product development incurs expenditure which is recurrent,* ***expenditure which is part of the regular cost of its trading operations.*** *That expenditure is, to adopt the words of Dixon J in Sun Newspapers, part of the process by which the organisation operates to obtain regular returns by means of regular outlays."*
> ***[emphasis added]***

Consistent with previous comments, the IAGC submits that the expenditure incurred in undertaking a multi-client survey is part of the regular cost of a Geophysical Services Providers ongoing business operations and is therefore on revenue account.

In summary, the adoption of a non-exclusive (multi-client) business model (as compared with an exclusive client model) by the industry does not change the practical business effect that in many cases the Geophysical Services Provider incurs the expenditure in undertaking the surveys in the ordinary course of business of providing a service and therefore the expenditure is incurred on revenue account.

The proprietary nature of the information exists only for the purposes of allowing the Geophysical Services Provider with the ability to monetise the information to a number of parties for multiple profit gains, thereby reducing the cost of the information to each party. In undertaking a multi-client data acquisition, industry practice is that through pre funding (generally 70% or more) and an expectation of near term sales (up to 4 years) the expenditure is essentially *a variation* of an exclusive or subcontractor type arrangement and it therefore follows that the expenditure should, in such cases, be treated immediately deductible under section 8-1.

The IAGC is of the view that there is a number of relevant cases referred to above that need to be considered in further detail and specific reference made to in any draft Tax Determination.

Submission Point 2:	**If the expenditure is considered to be capital and to form part of the cost of a depreciation asset, then the expenditure should be immediately deductible under section 40-80.**

Where the ATOs view that the expenditure is capital in nature is ultimately sustained, the IAGC submits that a deduction should then be available to the Geophysical Services Provider under section 40-80. Section 40-80(1) refers to depreciating assets that are first used in exploration or prospecting. Under this provision the entire cost can be claimed as depreciation in the year of the asset's first use. In order for this provision to apply the following conditions must be met:

(a) The first use of the asset needs to be for *exploration or prospecting* for minerals obtainable by *mining operations*. The IAGC submits that once the data is obtained, it is first used by the Geophysical Services Provider for petroleum exploration that is obtainable by the mining operations. The MQPI is used through its collection, review and processing as part of the business activities undertaken by the Geophysical Services Provider.

(b) The asset cannot be used for development drilling for petroleum or in the course of working a petroleum field. The IAGC submits that the data is not used in the course of working a petroleum field.

(c) When the asset is first used by the taxpayer for the required purpose, the taxpayer either:

(i) Carries on mining operations; or
(ii) Proposes to carry on mining operations; or
(iii) Carries on a business of, or a business that included, exploration or prospecting for minerals or quarry materials obtainable by such operations and the expenditure was necessarily incurred in carrying on that business.

In respect of item (c)(iii), the IAGC submits that there is no requirement for the Geophysical Services Provider to obtain the minerals or undertake the mining operations themselves, but rather that the exploration is for petroleum that is obtainable by mining operations.

(d) Is not applicable as it applies to mining, prospecting or quarrying rights.

(e) In the case where the asset is MPQI, the asset must be:

(i) Acquired from the Australian government
(ii) Must be acquired as part of a data package from a geophysical services provider; or
(iii) Must be created by the taxpayer or a Geophysical Services Provider

In respect of item (e)(iii), the IAGC submits that the asset is created by the Geophysical Services Provider and therefore this section is satisfied.

In considering the application of section 40-80, the IAGC submits that the SPA granted under the *Offshore Petroleum & Greenhouse Gas Storage Act 2006* in respect of multi-client activities provides that the Geophysical Services Provider (as the registered holder of the SPA) undertakes exploration activities (other than drilling) *in its own right.* This can be contrasted with the proprietary *I* service business model whereby the seismic services are undertaken for the Geophysical Services Provider's client and whereby alternative tenure exists (e.g. an exploration permit, retention lease). The ATO's view expressed at paragraph 43 of the proposed draft ruling is therefore inconsistent with the provisions of the *Offshore Petroleum & Greenhouse Gas Storage Act 2006* and specifically Part 2.7 of this legislation.

Specifically, section 230(1) of the *Offshore Petroleum & Greenhouse Gas Storage Act 2006* provides;

230 Rights conferred by petroleum special prospecting authority

(1) A petroleum special prospecting authority authorises the registered holder, in accordance with the conditions (if any) to which the authority is subject, to carry on, in the authority area, the petroleum exploration operations specified in the authority.

Furthermore, the IAGC submits that applying the immediate deduction available under section 40-80 to the expenditure incurred is consistent with the intention of the legislation and the ATO's own views in *ATO ID 2011/25: Capital allowances: immediately deductible expenditure - contractor providing geophysical surveying services to entities in the mining and minerals exploration industries.*

Specifically, ATO ID 2011/25 discusses the issue of whether the requirements 40-80(1)(c)(iii) will be met where a taxpayer is contracted to provide geophysical surveying services to entities in the mining and mineral exploration industries.

The ATO ID confirms that for the purposes of section 40-80(1)(c)(iii) , there is no explicit requirement in the section that the entity undertaking the exploration be the same party who undertakes the mining operations. Nevertheless, the ATO ID 2011/25 concludes that where a taxpayer is contracted to provide the geophysical surveying to entities (under an services or proprietary model) then it does not bear the requisite risk required for section 40-80(1)(c)(iii) to apply and is therefore not eligible for a deduction under section 40-80 for the cost of a depreciation asset.

However, the Commissioner also distinguishes companies that bear the economic risk of the exploration results and has concluded that:

> *"Having regard to the statutory context, purpose and the policy intent of subsection 40-80(1), to construe the meaning of the expression 'carry on a business of, or a business that included, exploration or prospecting for minerals or quarry materials obtainable by [mining] operations' for the purposes of subparagraph 40-80(1)(c)(iii) as extending to a taxpayer which carries on a business that provides exploration or prospecting activities on a contract basis is incorrect.*
>
> ***The better construction is that subparagraph 40-80(1)(c)(iii) only extends to entities who bear the economic risks of exploration or prospecting.*** *The Commissioner considers that subparagraph 40-80(1)(c)(iii)* ***recognises and assists entities in mineral exploration industries,*** *such as Junior explorers',* ***who explore or prospect for new mineral discoveries in the hope of marketing those discoveries to larger mining concerns, as opposed to developing or exploiting what is found themselves.*** *That is, mineral exploration companies who, as part of their business model, do not seek to involve themselves in mining operations. These are perhaps the entities in the mining and minerals exploration industry that proportionally bear the greatest risk of all and who accordingly attract immediate deduction in respect of the cost of the depreciating assets they first use in their exploration or prospecting activities.* ***[emphasis added]***

The IAGC submits that under the multi-client business model, the Geophysical Services Provider initiates and conducts projects of seismic survey (which meets the definition of exploration or prospecting for minerals) at its own financial risk. That is, these multi-client seismic surveys are pure exploration expenditure, and therefore bear a high commercial risk with the financial outcome dependent on the exploration potential discovered. New surveys that discover new information, for example identifying direct hydrocarbon indicators, when acquired over acreage locations that are soon to be available for E&P Companies will have immediate value and are typically licensed many times in a short period. On the contrary, where the survey fails to produce new information regarding direct hydrocarbon indicators, or the area covered is not expected to be available in the short term, then the dataset is typically only licensed by those companies holding existing permits within the survey area. To reduce the upfront data pricing under each licensing contract, seismic contractors are often forced to take on some of the immediate exploration risk of the licensees, by deferring a portion of the licensing fees until key milestones are met by the licensee (e.g. bid for / or award of an exploration permit).

The IAGC therefore submits that the reasoning applied to that of a junior explorer as specifically discussed in ATO ID 2011/25, or a farmee as discussed in the Miscellaneous Taxes MT 2012/1 and 2012/2, should equally be applied to a Geophysical Services Provider undertaking a multi-client survey, where that entity bears the economic risk of the exploration and prospecting undertaken.

The fact that purchasers of the multi-client data undertake further exploration activities using the data does not in any change the character or nature of the exploration activities and risk profile of the Geophysical Services Provider that undertakes the multi-client survey in the first instance.

On this basis, the IAGC submits that if the expenditure is considered to be capital in nature, all requirements of section 40-80(1) can be satisfied in relation to the non-exclusive (multi-client) seismic data and therefore the cost of the depreciating asset, being the MPQI will be immediately deductible.

Submission Point 3:	**If the expenditure is considered to be capital and to form part of the cost of a depreciation asset, the final Taxation Determination must address the manner and nature in which a balancing adjustment event occurs and a balancing adjustment can be claimed.**

In our meeting on 8 September 2017 we discussed the circumstances in which a balancing adjustment event (and hence charge) may arise under Division 40 in respect of multi-client seismic data. This discussion specifically arose in the context of the significant difference between the industry's assessment of the economic life of multi-client seismic data and the statutory 15 year life imposed under section 40-80.

The IAGC submits that if the expenditure is considered to be of a capital nature and to form part of the cost of a depreciating asset, and is not otherwise immediately deductible under section 8-1, then the proposed draft Taxation Determination should contain examples of what events would trigger a balancing adjustment for the Geophysical Services Provider. Specifically, guidance on the ATO view as to the application of section 40-295(2) and 40-295(3) of the ITAA1997 to multi-client data would provide industry with a framework to assess the economics of the multi-client business.

In particular, the IAGC submits that examples should allow for the Geophysical Services Provider to claim a balancing adjustment where the Geophysical Services Provider meets the requirements of the legislation, for example by reaching the view that the asset has no further value as evidenced by the write off of the asset for accounting purposes or other business documentation that demonstrates the expectation that the data cannot be commercialised further and will no longer be used for any purpose.

This guidance should be specific in terms of the ATO's view as to the requisite likelihood / probability of future sales that needs to be assessed in order for a balancing charge to arise.

The IAGC requests that the ATO confirm that the Geophysical Services Provider is not required to legally relinquish its proprietary rights contained within the data licences nor remove the information from its data library in order to claim the balancing adjustment. The IAGC submits that where the data for which a balancing adjustment has previously been claimed is re-processed, sold or licenced in the future, the asset will start to be held again by the relevant taxpayer.

The proposed draft Tax Determination also does not identify the precise MQPI asset for the purposes of Division 40 of the ITAA 1997. Given the potential application of the balancing adjustment provisions, the identification of the precise asset raises uncertainty as to the application of the balancing charge provisions. The IAGC requests the ATO clarify the precise asset that constitutes MQPI.

For example:

1. Is each item of MQPI defined by reference to each graticular block or in the ATO's view is there an alternative basis of asset identification?

2. Does further processing or reprocessing give rise to a new asset or is it an addition (second element of cost) to the original asset?

Other considerations

The IAGC considers that the ATO's view that the expenditure incurred by the Geophysical Services Provider is capital in nature and therefore forms part of the cost of a depreciating asset also presents additional complexity and inconsistencies for the following reasons:

- There will generally be significant difficulty in apportioning direct and indirect expenditure to each parcel of data. In particular, the proposed draft Taxation Determination cites various costs at paragraph 8 that comprise the typical expenses incurred. The commentary as to the tax treatment of costs does not address whether indirect costs such as selling, marketing and general and administrative costs that would be required to be capitalised to the cost of a depreciating asset or are outright deductible. This will be particularly the case where the business undertakes both multi-client and exclusive data surveys as well as other oilfield services during a particular income year.

- Although the proposed draft Taxation Determination and the Explanatory Memorandum[6] to the tax law changes propose that mining information is created over time and therefore developing and enhancing data is added to the original cost of the asset, the IAGC submits that this treatment is over-simplistic and does not necessarily accord with the nature of the processing of the data in the industry. For example, the IAGC submits that the industry's varied approach to both the collection and processing of the data creates a substantially different product that could be treated as a separate unit of property Therefore, the ATO's

[6] Explanatory memorandum to the Tax and Superannuation Laws Amendment (2014 Measures No.3) Bill 2014 and Superannuation Laws Amendment (2014 Measures No.3) Act 2014.

views on the characterisation of individual assets will need to be confirmed as part of the proposed draft Tax Determination.

- The tax treatment of software licences varies greatly to the tax treatment adopted for licencing of multi-client seismic surveys. As outlined in *Taxation Ruling TR 93/12: Income tax: computer software*, where software is produced or developed for licence rather than for sale, i.e. where title to the software remains with the software developer or supplier, and the developer or supplier carries on a business of trading in software licences, the licences are considered to be trading stock and should be brought to account as such in calculating the taxable income of the software manufacturer, developer or distributor. The IAGC submits that inconsistencies in the tax treatment of similar business models across industries is not appropriate and accordingly, the ATO's views on the multi-client seismic industry need to be revisited in light of the positions adopted for other industries. The proposed draft Tax Determination makes reference at paragraph 13 to the 14 May 2013 date of the legislative change to introduce the 15 year write-off period. Given the nature of multi-client data and the way in which data is acquired and augmented, the IAGC requests that the ATO clarify the date by which MQPI starts to be held for the purposes of Division 40. This issue requires clarification of the asset (as referred to in submission point 3) and the identification of the point of "first use". The IAGC submits that first use of each item of MQPI can be expected to occur on commencement of the multi-client acquisition for that item.

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We trust that the above submission will be considered by the ATO in developing its views prior to the release of the draft Taxation Determination. Please contact me (bruce.williams@tgs .com or +61 417 968 590) if you have *9ny* further questions.

Yours faithfully,

Bruce Williams

IAGC Austral Committee