

9 February 2018

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By email: kenneth.wee@ato.gov.au

Copy to:

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Department of Industry, Innovation and Science:	Ms. Lisa Schofield (Head of Resources) and Mr. Michael Sheldrick (Head of Onshore Energy)
Department of Treasury:	Ms. Maryanne Mrakovic (Deputy Secretary)
ATO:	Mr. Andrew Mills (Second Commissioner) and Ms. Louise Clarke (Deputy Chief Tax Counsel)
EY:	Mr. Chad Dixon (Partner) and Ms. Anna Satinover (Snr Manager)

**Submission to draft Taxation Ruling TR 2017/D11
International Association of Geophysical Contractors**

Dear Kenneth,

This submission is made on behalf of the International Association of Geophysical Contractors (**IAGC**) regarding draft *Taxation Ruling TR 2017/D11 Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data (TR 2017/D11)*.

As the global industry body representing key participants in the multi-client seismic data industry, the IAGC continues to have serious concerns regarding the Australian Taxation Office's (**ATO's**) views of the taxation of multi-client seismic data and the significant impact this will have on multi-client activities and exploration in Australia.

These concerns have been previously raised by the IAGC during our consultation with the ATO on the technical interpretation of the tax law prior to the release of TR 2017/D11, and include our written submissions to the ATO dated 22 September 2017 and 1 December 2017, our correspondence with Andrew Mills, ATO Second Commissioner on 6 November 2017 and subsequent teleconference on 11 December 2017.

The IAGC has also raised these concerns with the Department of Industry, Innovation and Science (**Department of Industry**) in the context of the impact this taxation treatment will have on exploration in its teleconference on 23 November 2017 and subsequent correspondence dated 1 December 2017 and 30 January 2018.

The IAGC has not sought to reproduce all matters contained in these prior submissions, but has drawn upon aspects of this content for the purposes of the key submission points to TR 2017/D11. The IAGC requests that this submission is read in conjunction with those previous submissions.

Confidentiality of data

In preparing this submission, the IAGC has consulted with its members to ensure the submission reflects current Australian industry practice and its member's concerns regarding the ATO's proposed view of the taxation of multi-client seismic data.

However, please note certain information contained in section 4 and Appendix F of this submission contains highly confidential data which was obtained by directly surveying impacted member companies. This data is commercially sensitive and cannot be shared between individual member companies of the IAGC or their employees.

Given the highly confidential and sensitive commercial nature of this data, we hereby request this submission be kept strictly confidential and only be circulated to ATO officer to the extent their involvement is necessary in consideration of this matter.

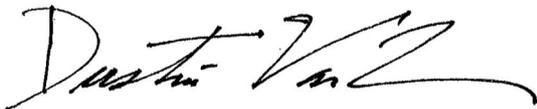
Contact details

We trust that this submission will guide the ATO in its finalisation of *Taxation Ruling TR 2017/D11* and the IAGC would welcome the opportunity to discuss the matters raised in further detail.

The IAGC will also forward a copy of this submission to the Minister for Resources and Northern Australia, the Department of Industry and the Department of Treasury.

Given the commercially sensitive information contained in this submission, should you have any have questions in relation to the matters covered in this submission, please contact Chad Dixon of EY on +61 8 9429 2216 or me (dustin.vanliew@iagc.org or +1 713 957 8080) in the first instance.

Yours faithfully,



Dustin Van Liew
VP, Regulatory & Governmental Affairs
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1. Introduction and outline of submission

Overview of IAGC

- 1.1 The IAGC is the global trade association representing the geophysical industry for over 45 years. The IAGC focuses on issues that affect the core business of the industry, including data acquisition, data processing and data ownership.
- 1.2 The IAGC represents key participants in the multi-client seismic data industry both globally and in Australia. Undertaking multi-client seismic activities is a key business activity for seismic companies in this industry and Australia is a key market for these activities.
- 1.3 The multi-client (non-exclusive) business model has emerged in Australia in recent years as a means to maximise the discovery and ultimately the exploitation of hydrocarbons by providing multiple parties, including Governments and Energy & Petroleum Companies (**E&P Companies**) with an ability to immediately access the exploration information produced from the seismic survey. The multi-client model is an alternative and/or complementary business model to the traditional service model to a single customer, and facilitates a lower cost for each user of the data by spreading the cost over multiple parties leaving the commercial and financial risk of the survey with the seismic company.
- 1.4 The taxation outcomes in Australia in respect of multi-client activities have a key bearing on the sustainability of the industry and the future of exploration in Australia, affecting both companies active within this multi-client business, and those E&P Companies that rely on the exploration information provided by multi-client surveys for their own further exploration purposes.

Outline of submission

- 1.5 This submission sets out the IAGC's views on the ATO's draft *Taxation Ruling TR 2017/D11 Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data (TR 2017/D11)*.
- 1.6 In making this submission, the IAGC acknowledges that the multi-client business model has only emerged in Australia in the last 25 years, to now become an increasing and essential source of exploration information for the oil and gas industry.
- 1.7 This business model represents a significant variation to the traditional proprietary (fee for service) contract model. The IAGC also understands the associated tax consequences have only become a recent focus for the ATO as a result of changes to the tax law with effect from 14 May 2013, requiring certain mining, prospecting and quarrying information (**MPQI**) to be depreciated over 15 years for Australian tax purposes.
- 1.8 The IAGC continues to submit the tax position in TR 2017/D11 incorrectly applies the tax law as it is based upon selective facts of the industry's activities as well as applying undue weight to those factors (compared with other factors which the IAGC believes counter the ATO's position).
- 1.9 It is the view of the IAGC that the application of the Australian tax law to the full business model of multi-client companies requires a deeper analysis of the purpose, activities and risks undertaken by multi-client companies. Further, the IAGC believe this added analysis will establish for the ATO, that the costs associated with multi-client data collection and processing are immediately deductible for tax purposes.

- 1.10 In view of the above, this submission contains the following information:
- 1.10.1 A detailed description of the multi-client business model, including the process by which multi-client companies undertake multi-client activities, the purpose of activities, the focus of the business on exploration activities, the terms of the government licences / authorities under which exploration is undertaken, the risks assumed by the multi-client company and the usage of the information by the multi-client company itself.
 - 1.10.2 A detailed technical analysis of the legislative provisions, relevant case law and other guidance concerning the revenue vs capital characterisation of expenditure, trading stock, exploration deductions and balancing adjustments. This analysis applies the taxation law to the specific facts and circumstances of the multi-client industry, having regard to the wording of the legislation and also where relevant, policy.
- 1.11 Appendix A to this submission includes a detailed list of all specific submission points raised in respect of TR 2017/D11.
- 1.12 This submission should be read in conjunction with the IAGC's written submissions dated 22 September 2017 and 1 December 2017, and correspondence with Andrew Mills, Second Commissioner dated 6 November 2017 as part of the IAGC's consultation with the ATO prior to the release of TR 2017/D11. These have been included as Appendices B, C and D to this submission.
- 1.13 This submission should also be read in conjunction with the IAGC's submissions to the Department of Industry on 1 December 2017 and 30 January 2018. These have been included in Appendices E and F.
- 1.14 All section references in this submission are to the *Income Tax Assessment Act 1997* unless otherwise stated.

2. Key submission points

Defining the multi-client business

- 2.1 The IAGC submits the proposed tax treatment outlined in TR 2017/D11 is incorrect on the basis:
- 2.1.1 The ATO has applied the tax legislation to a narrow subset of multi-client activities which do not reflect and hence fail to recognise the broader activities and business model of companies operating in the multi-client industry.
 - 2.1.2 This narrow view has focused purely on new project (i.e. new data acquisition) activities, and ignores the ongoing core business exploration activities of the multi-client business, leading the ATO to an incorrect presumption the multi-client company undertakes exploration activities as a services provider for, and on behalf of, E&P companies.
 - 2.1.3 The proposed tax outcomes in TR 2017/D11 are fundamentally guided by the legal form of the licencing arrangements and fail to take into account the substance, commercial purpose and commitments of the multi-client company in undertaking the exploration activities. Such exploration activities would have traditionally been undertaken by an E&P company and TR 2017/D11 fails to correctly identify the correct business relationship between the multi-client company and E&P company.
 - 2.1.4 TR 2017/D11 has an inconsistent and incorrect approach to defining the use of the information by the multi-client company, including how and when the data is used by the multi-client company.
- 2.2 The information contained in this submission clearly demonstrates that multi-client companies undertake high risk exploration on their own account for the purposes of producing assessable income. The profitability of the business model is in most cases dependent on the exploration discovery success of the multi-client survey, coupled with the monetising of the results of such exploration information immediately by way of revenues from upfront licencing contracts, which are akin to a sale of information with restricted use.
- 2.3 In view of the above, the focus of this submission is that the expenditure incurred by multi-client companies is exploration. By establishing that such expenditure is exploration, the multi-client company will be entitled to claim an immediate deduction under the exploration provisions in section 40-80 for the expenditure, to the extent that a deduction is not otherwise available under section 8-1 (as noted at section 6 to this submission, the IAGC contends that an immediate deduction may be available for such expenditure as revenue in nature).
- 2.4 In this respect, it is noted that as per the principles of Taxation Ruling TR 2017/1 Income tax: deductions for mining and petroleum exploration expenditure, that:
- 2.4.1 Division 40 is not an exclusive code for deductions for exploration expenditure. An immediate deduction may be available under the general deduction provision (section 8-1)¹.
 - 2.4.2 There is no presumption that exploration expenditure is capital, or capital in nature. Similarly, there is no presumption that exploration expenditure is of a revenue

¹ Paragraph 7 of Taxation Ruling TR 2017/1

nature. Regard must be had to the nature and character of the expenditure in light of all the facts and circumstances².

- 2.4.3 The mere fact that expenditure produces “information” is not of itself 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 account³.
- 2.4.4 Although the wording of section 8-1 contemplates apportionment of an outgoing, expenditure that indifferently serves both a revenue and capital purpose may not be capable of dissection on the basis of some arithmetic or rateable division. In such a case, apportionment proceeds on some fair and reasonable basis. If apportionment is not possible on that basis, the nature of the expenditure is determined by the essential character of the outlay as a whole⁴.

- 2.5 Consistent with these principles, the IAGC submits that the core business of a multi-client company involves undertaking exploration activities and therefore an immediate deduction should be afforded under section 40-80 (or 40-730) to the extent that expenditure incurred by the multi-client company is considered capital in nature.

Tax treatment of expenditure

- 2.6 Having regard to the key principles of the multi-client business model as outlined in this submission, the tax treatment of expenditure incurred in undertaking multi-client activities should recognise the following:
 - 2.6.1 That multi-client companies, by the nature of their business model, incur expenditure on a recurring and regular basis in analysing the prospectivity of exploration acreage, undertaking multi-client surveys and marketing the exploration information to derive assessable income in the very short term. Therefore, the character of the expenditure incurred in such instances is revenue in nature and deductible under section 8-1;
 - 2.6.2 If the expenditure (or part thereof) is however considered to be capital and to form part of the cost of a depreciating asset (i.e. MPQI), then the expenditure is immediately deductible by the multi-client company as eligible exploration expenditure in accordance with section 40-80. This is because the multi-client company undertakes exploration in its own right and at its own risk under specific authority issued by the Australian Government which permits the multi-client company to explore and that exploration information is first used and exploited by the multi-client company by identifying new petroleum discovery opportunities (e.g. by locating direct hydrocarbon indicators evident within the exploration data), and then exploiting that new information by both the licensing of the survey data, and potentially conducting further exploration to produce additional exploration information;
 - 2.6.3 If the expenditure is considered to be capital and to form part of the cost of a depreciating asset for which no exploration deduction is available, a balancing adjustment event should occur in the year that there is no further proposed use of that survey data, determined by reference to either internal prospectivity reviews or via forecast of new licensing commitments. The balancing adjustment should be allowed regardless of whether existing licences remain legally in place, as the multi-client company’s use of the data is not dependent on existing licencing arrangements and will cease to use the asset once there is no further ability to

² Paragraph 18 of Taxation Ruling TR 2017/1

³ Paragraph 23 of Taxation Ruling TR 2017/1

⁴ Paragraph 23 of Taxation Ruling TR 2017/1

licence or use the data for prospectivity reviews. In these circumstances, only the E&P Company holding the information can be considered to continue to use the data under terms of the licence.

- 2.6.4 If the ATO maintains its views that the legal form of the data licence represents fundamentally the core business of the multi-client company, then the multi-client company should be regarded as trading in data licences such that the trading stock provisions apply to the data licences. By applying section 70-25 in accordance with the ATO's own principles as espoused in Taxation Ruling TR 93/12, expenditure incurred on collecting and processing multi-client data will not be an outgoing of capital, or be capital in nature.
- 2.7 The IAGC submits the views expressed in this submission apply the tax legislation to the multi-client business consistently and correctly, and should form the basis for the tax position outlined in TR 2017/D11. These key submission points are covered in detail in the further content in this submission.
- 2.8 A detailed list of all specific submission points for each relevant paragraph of TR 2017/D11 has also been provided at Appendix A.

Prospective application date of TR 2017/D11

- 2.9 Crucial to the industry is that the TR 2017/D11 should apply prospectively only, to the extent any position outlined in the final published ruling results in an adverse outcome to a taxpayer relative to the position which would have arisen if the principles in TR 93/12 were adopted.
- 2.10 In the IAGC's opinion, such prospective application must be afforded pursuant to the ATO's own policy as expressed in Practice Statement 2011/27 dealing with U-turns on clear industry practices on the basis that:
 - 2.10.1 Industry participants have long taken (and retain) the view that expenditure incurred on obtaining multi-client information is on revenue account and immediately deductible.
 - 2.10.2 Industry participants have historically relied on the protections afforded by other legislative provisions to ensure there was no significant risk to the tax timing of expenditure, to the extent the expenditure was held by the ATO to be on capital account. These protections include the ability to claim a deduction for the costs of the information under the trading stock provisions pursuant to the principles of paragraph 7 in Taxation Ruling TR 93/12 dealing with software.
 - 2.10.3 The tax law amendments which introduced a statutory life of 15 years for the effective life of 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. This legislation specifically excluded expenditure on the acquisition of data from seismic companies. There is nothing in the explanatory guidance to these amendments that would indicate these provisions were intended to apply to the multi-client industry and it is the IAGC's view that this amendment was directed towards resources companies undertaking transactions at a premium. In the IAGC's opinion, the outcomes of the tax law as set out in TR

2017/D11 are clearly anomalous and unintended in this respect and need be recognised by the ATO as such.

- 2.10.4 Despite the tax law amendments applying to any MPQI held on or after 7:30pm AEST on 14 May 2013, the ATO has not released any guidance over more than 4 years in relation to the application of these provisions to the multi-client industry.
- 2.10.5 Deductibility of exploration expenditure and the oil and gas industry have been a key focus area of the ATO for many years and the ATO has previously published ATO ID 2011/25 in relation to geophysical service contracts. However, no further ATO guidance has been issued in respect to the multi-client industry until now, with the proposed view at significant odds with general industry practice and commercial reality.
- 2.11 In view of the above, the IAGC submits that having regard to the ATO's conduct in dealing with this matter, that multi-client companies must be afforded protection from retrospective application of the ATO's views, if the position taken by the ATO does not allow expenditure to be immediately deductible under section 8-1 or section 40-80 and the ATO maintains that the licences are not allowable as trading stock.
- 2.12 Prospective application should commence from the date of finalisation of the ruling.

Purpose of TR 2017/D11

- 2.13 The IAGC and its members place significant importance on obtaining certainty from the ATO as to the taxation treatment of expenditure incurred in conducting multi-client activities.
- 2.14 However, the need for certainty cannot outweigh the correct application of the tax law. Given the concerns noted by the IAGC in this submission, including: that a wide range of business models and factual circumstances exist, that there is a spectrum of arguments regarding the revenue vs capital distinction, that there are differing views on the policy intent and application of the exploration provisions, and the small number of multi-client participants that will ultimately be affected by this TR, careful consideration should be had as to the purpose of this TR and the precedent it may set, particularly given the industry's concerns that a full understanding of the business model and activities has not been recognised in the current TR.
- 2.15 In view of the above, the IAGC and its members would be willing to accept the withdrawal of the draft TR on the basis that there is significant difficulty in providing an appropriate ruling given the divergence of views and possible applications of the law to each multi-client company's facts and circumstances.
- 2.16 Importantly, through the ongoing consultation between the IAGC and the ATO, each member of the multi-client industry has been made aware of the ATO's focus on this industry. Given that all impacted members will be assessing their positions and considering initiating separate ATO communications, it is the view of the IAGC and its members, that the issue of the TR in its current form will in no way further benefit the industry or result in the intended purpose of a ruling, being the communication of the ATO's views on a particular issue to a broad class of taxpayers.

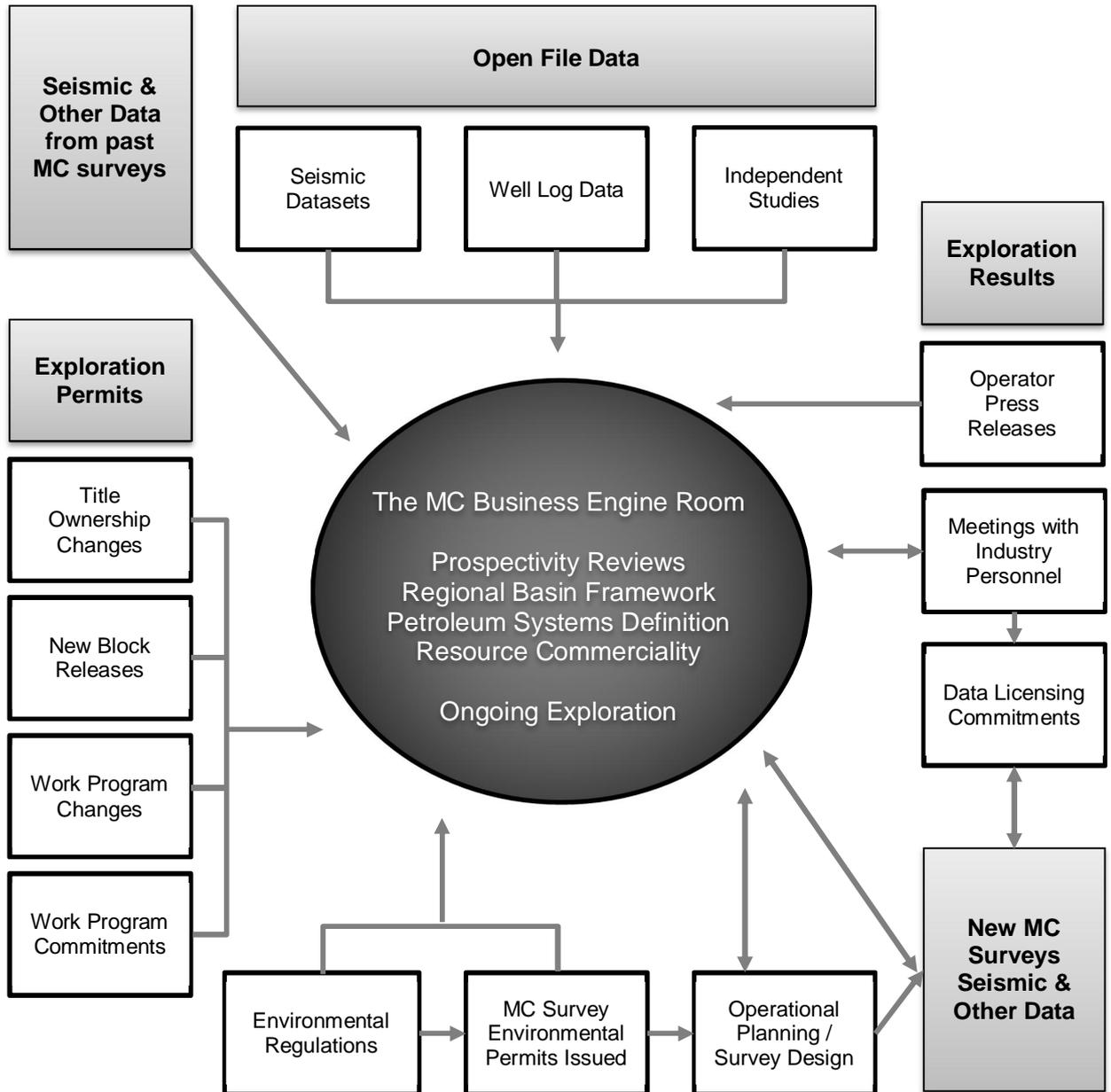
3. Industry information regarding the multi-client data business model

Multi-client business model and activities

- 3.1 Geophysical service companies originally provided their specialist services (e.g. the collection of seismic survey data), solely under a classic “fee for service” (or proprietary services) contract. The contractor’s role in this capacity was limited to the provision of specialist equipment and staff, and to follow the specific operating instructions of the client (typically the permit operator). The operator would set the technical acquisition parameters and processing flow, would obtain any necessary permits, and would provide a representative onboard the vessel to supervise the operations. The permit operator would take ultimate legal responsibility for the operational risks during the acquisition operations.
- 3.2 Each permit operator would separately contract the acquisition and processing of seismic data that they required for their individual permit’s exploration programs. In many cases, geophysical contractors would mobilise their vessel long distances (often internationally) to perform small scale survey operations for one permit operator.
- 3.3 As the geophysical industry developed, the multi-client business model evolved by promoting a more efficient utilisation of the vessel and operations staff, and exploiting the accumulated exploration knowledge within the contractor company. Separate nearby survey engagements were consolidated to more effectively utilise the mobilised vessel (**group shoots**).
- 3.4 Further expansion of survey areas the subject of these group shoot operations may have been initiated when the geophysical contractor believed that an adjacent area was likely to also be prospective for oil and gas, and that the resultant information could be licensed to parties interested in further exploring that adjacent area. Often several companies were interested in reviewing the adjacent area, but none would individually fund a survey on their own account. This consolidation of many companies’ exploration interests, created the multi-client business model. In addition to these adjacent area surveys, vessel operators, and third-party investors often identified further new exploration ideas to utilise the seismic vessels whilst between performing surveys under contract for permit operators.
- 3.5 Through commodity price fluctuation, many permit operators downsized their internal staff numbers, shedding capability in survey operations planning, survey and environmental permitting, stakeholder consultation, inhouse geophysical processing capabilities, data interpretation and even prospectivity reviews. These core exploration skills were outsourced to contractors, including multi-client seismic companies.
- 3.6 The accumulation of these exploration skills, coupled with the extensive information contained within their seismic libraries, has allowed multi-client companies to develop teams that constantly study all available information to help conceive their own exploration ideas, By promoting those new ideas to operator companies, and attracting data licensing commitments, it allows new exploration activity to be initiated with the funding, under permits and legal titles, and at the commercial risk of the multi-client company.
- 3.7 The outcome of the trends described above is that the multi-client industry is now made up of specialist multi-client companies as well as specific business units within other diverse exploration companies, whose sole focus is on exploration and production of new exploration information via multi-client activities.

3.8 The functions of these multi-client exploration business companies/business units are shown diagrammatically below.

Figure 3.8: Multi-client exploration business model



Process and timeline of multi-client activities

3.9 The project stages, process and indicative timeline of a multi-client activity are outlined below:

Table 3.9: Project stages and lifecycle

Project Stages	Description	Indicative Timeline
1. Prospectivity Review / New Project Development	The interpretation of existing exploration datasets, prospectivity studies, evaluation of latest available exploration news and information is a constant process. Multi-client companies employ their own geologists and geophysicists to evaluate all exploration data and prospects.	Continuous / ongoing
2. Petroleum Special Prospecting Authority (SPA) title	The SPA “authorises the holder to carry on petroleum exploration operations ... (but not to make a well)” (s.229 of the <i>Offshore Petroleum and Greenhouse Gas Storage Act 2006</i>), over open areas, i.e. those not yet awarded as an Exploration Permit, Production License, Retention Lease etc.	Two months
3. Petroleum Access Authority (AA) –	The AA authorises the SPA titleholder to expand the petroleum exploration operations in areas also held under an Exploration Permit, Production License, Retention Lease etc.	Two to six months
4. Environment Plan (EP)	EPs are required for all petroleum activity conducted by any titleholder.	Six months to greater than two years
5. Survey Design & Modelling,	This includes processing flow to optimise imaging at intended exploration target depths	Multiple iterations through project development phase
6. Infield Petroleum Exploration Operations	This stage refers to the survey vessel acquisition period. The timeline for this activity is proportionate to survey scale, plus mobilisation distances, crew change rotations, weather, vessel downtime, obstacles, downtime to mitigate potential environmental disturbances or impacts on other stakeholders (exploration, tourism, fishing etc).	Varies, dependent upon scale of activity.
7. Geophysical Processing & Imaging	This work is partly undertaken in some cases onboard the vessel; in all cases additional work is completed in onshore data processing centres.	Dependant on chosen processing flow, and size: 2Dimensional data: 4-14mths 3Dimensional data: 9-18mths
8. Interpretation of data collected	Multiple iterations through the processing and imaging phase, and recommencing immediately on availability of final migrated products.	Continuous / Ongoing.

- 3.10 Australian multi-client seismic surveys are regulated by the Offshore Petroleum and Greenhouse Gas Storage Act 2006, and the Offshore Petroleum and Greenhouse Gas Storage (Environment) Regulations 2009, which require the multi-client company to obtain specialised titles and approval of an environment plan prior to the commencement of any petroleum exploration operations.
- 3.11 The processes required in application for and the conditions of a Special Prospecting Authority title are further detailed in the following Department of Industry factsheet: <http://www.nopta.gov.au/documents/guidelines/SpecialProspectingAuthoritiesAccessAuthoritiesScientificInvestigations.pdf>

Comparison of multi-client business model, service model and E&P model

- 3.12 Having regard to the business model outlined above, the following table illustrates the general functions undertaken by multi-client companies as compared to a “shoot for service” contract or E&P in-house exploration function,
- 3.13 In considering the following table, please note each individual business is bespoke and will adopt all or some of these business models in their own business to various degrees at different times. In addition, individual projects may utilise a combination of these models as and when commercially expedient.

Table 3.13: Comparison of business models

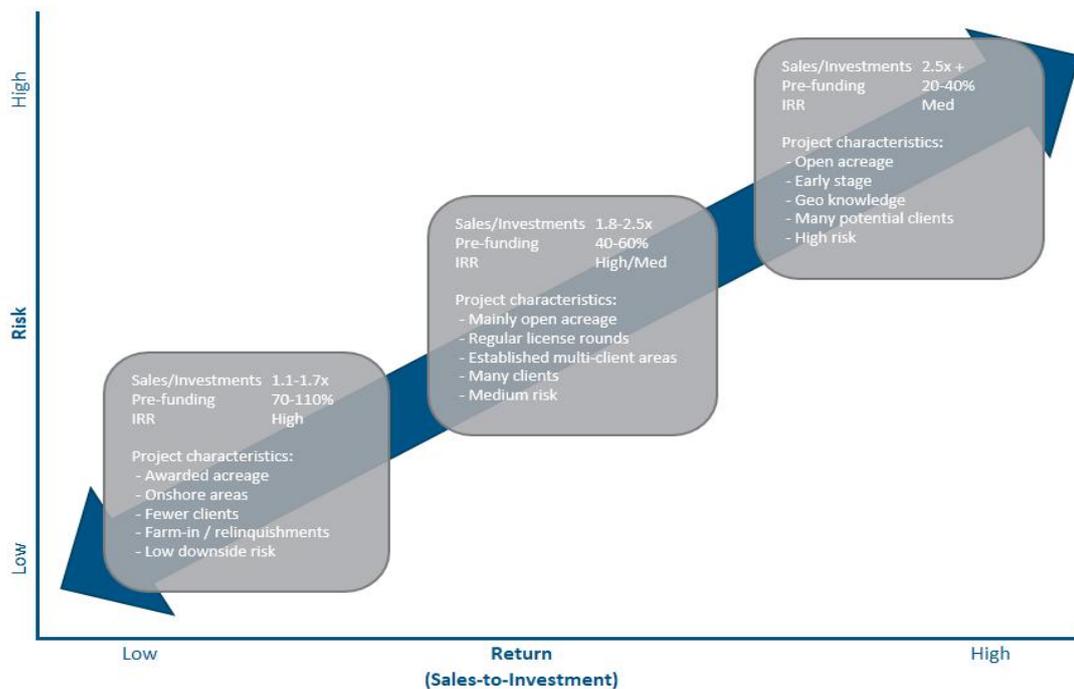
Project activity	Traditional services (i.e. “shoot for service”) model	Multi-client business model	E&P company model
Business model	Provides a service to collect data on behalf of a specific E&P company.	Explores for and develops a data product on its own account for use in its own business.	Explores for and develops a data product on its own account for use in its own business.
Survey design	Undertakes survey at the direction of E&P company.	Designs survey based on own prospectivity studies and market interest – developing prospects, delineating reservoirs and identifying drilling locations. Also for use in evaluation of new permit area releases (i.e. “bid rounds”)	Designs survey based on own interests having regard to own prospects and leads in identifying drilling locations. Surveys conducted post award of exploration permit.
Risk of survey	No risk to services company. Provides all inputs (e.g. vessel and crew) under contract to Permit operator company. Permit operator company pays full cost of project.	Multi-client company bears all risk, pays full cost of project (financial risk can to various extent be mitigated by pre-financing from customers).	E&P company bears all risk, pays cost of project (financial risk can be mitigated by joint venture / farm-out arrangements).
License title	Undertakes survey under title of E&P company.	Undertakes survey under own statutory title (SPA; AA; EP – refer table 3.9 above) which permits the exploration.	Undertakes survey under its own statutory title which permits exploration.
Ownership of data	Does not own the geophysical data.	Owens the geophysical data.	Owens the geophysical data from “traditional services” arrangements or licences the geophysical data from “multi-client” arrangements.

Project activity	Traditional services (i.e. “shoot for service”) model	Multi-client business model	E&P company model
Use of data	May review and interpret data for hydrocarbon indicators on behalf of E&P company if such services form part of contract with E&P company.	Continuous review and interpretation of all available data for hydrocarbon indicators. Undertakes multiple iterations of prospectivity review through each new project’s processing and imaging phase.	Continuous review and interpretation of all available data for hydrocarbon indicators. On data delivery at completion of the processing and imaging phase, commences reviews of new project data.

Risks assumed by multi-client companies

- 3.14 As highlighted above, with the evolving nature of the exploration and resources industry and the introduction of the multi-client business model, multi-client companies have taken on the traditional exploration functions of E&P resource companies, thereby taking on significant risk in their own right to explore for and generate new exploration information.
- 3.15 New exploration surveys are initiated by the multi-client investor when they believe that their prospectivity studies identify an area that will be of sufficient interest to the global exploration industry to produce data licensing revenues in excess of their costs. In many cases data licensing contracts are committed before the survey is initiated (pre-funding). The level of pre-funding required to support any survey investment decision is entirely dependent on the balancing of all project risks and future revenue probabilities by considering the continuous investments in a global/multi-national project portfolio. Each company will assess these risks and probabilities differently, and therefore initiate surveys at differing levels of pre-funding.

Figure 3.15: Range of projects and risk return profiles



3.16 Multi-client investor companies are very focused on near term cashflows from licensing contracts, to provide sufficient funds to ensure a continuous program of investment into new projects. The majority of committed licensing fees are payable immediately on delivery of the data (for new projects payments are typically required earlier – during the vessel acquisition and processing phase). On all but the most minor projects, near term cashflows are the key target of every new project investment decision. When analysing potential project investments, every subsequent year revenue projection is progressively discounted by time value of money factors. Revenues beyond 4 to 5 years after completion of processing are typically ignored in investment analysis decisions. Information values are timely, with new exploration information most valuable when first available and most valuable to those companies that currently have title over the permits within the survey area. As a consequence, revenue patterns for multi-client seismic surveys are typically front-end loaded, with the vast majority arising in the survey acquisition and processing period plus the next 1-2 years (refer to Section 4 and Appendix F).

3.17 The key financial, operational and exploration risks assumed by the multi-client company in pursuit of exploration are further outlined below.

Financial risk as project owner:

3.18 In undertaking exploration work in their own right, multi-client companies incur a significant financial commitment in relation to continuous prospectivity review and interpretation of all available exploration data, news and information by the staffing of local offices, and contracting of external specialist advisors when required. In addition to this ongoing commitment, the multi-client company incurs substantial financial risk when initiating the permitting process for potential exploration projects. The extensive permitting process incurs significant labour and consultant costs, and government charges, during the following:

- The permit application process;
- The stakeholder consultation process;
- The assessment of the physical, biological and socio-economic environment; and
- The risk assessments and mitigation strategies compiled within the environment plan.

3.19 The dominant financial risk of any multi-client survey is incurred when the multi-client company commits to the vessel contractor, which typically incurs fixed mobilisation charges, plus day-rate charter costs (e.g. for the crew operating the vessel) for the duration of the survey. In addition, the multi-client company will directly engage supplementary crew to provide specialised exploration roles on-board the vessel.

3.20 These contracts expose the multi-client company as project owner to all operational risks of the estimated vessel acquisition period, and importantly to any extensions to that period, however they may be caused (e.g. downtime caused by weather, adverse sea conditions and currents, vessel and equipment breakdown or technical failures, obstacles, downtime to mitigate potential environmental disturbances (marine mammals, marine parks & other sensitive locations), downtime to mitigate impacts on other stakeholders (other exploration activities, tourism, fishing etc).

3.21 The multi-client company will generally seek to reduce some of their financial risk exposure by entering contracts to pre-commit E&P companies to license a copy of data products resulting from the multi-client survey. These data licensing contracts are a product focused contract at agreed prices (e.g. \$/sqkm), and typically have no price adjustment for the actual costs incurred by the multi-client company. The licensing revenues reduce some of the

financial risk, but they do not directly offset the risk exposures taken on by the multi-client company in undertaking the exploration work.

- 3.22 Each new project’s final investment decision is made after assessing the estimated project costs, coupled with all the risk exposures, reduced by financial contribution from pre-committed licensing contracts – to the extent that any are in place at the time of the project investment decision. Different multi-client project owners may justify their investment decision with different levels of pre-committed licensing. Some projects are initiated with no pre-committed licensing.
- 3.23 The financial risk assumed by the Project Owner typically is highest at the time of the project investment decision / vessel charter commitment (unless unexpected project cost increases occur).
- 3.24 In parallel to conducting the exploration operations, the Project Owner will continuously promote the prospectivity of the survey area, and seek additional commitments to license data products that will result from the survey. Whilst different multi-client companies identify key revenue phases under different terminology, for all multi-client projects there are two clearly distinguished phases of committed revenues from licensing contracts:

Pre-Commitment Revenues

The committed revenue portion (i.e. excluding all contingent milestone payments), arising from data contracts entered into prior to the Project Owner’s final investment decision. The forecast revenues from the committed portions of these contracts reduces the Project Owner’s Financial Risk undertaken at time of the investment decision.

Subsequent Revenues

Any revenues that crystallise after the Project Owner’s final investment decision. These include:

- i. Committed revenues arising from new data licensing contracts entered into during the project’s work-in progress phase,
- ii. Committed revenues arising from new data licensing contracts entered into after completion of the project (often termed “Late Sales”), and
- iii. Contingent revenues arising at the time of a risked milestone event (for example – on acquisition or award of an Exploration Permit within the area of the survey) (often termed “Uplifts”).

“Pre-funding” during WIP phase

- 3.25 In the IAGC’s submission dated 22 September 2017, we identified that multi-client project owners generally seek to secure a significant portion of “pre-funding” during the work-in-progress period. This was estimated to be in the range of 70% to 100% of project costs. As referred to above, the terminology used differs between companies, but for clarity we note that the revenues referred to in that earlier submission as “pre-funding” during the WIP phase include those described above under (a) Pre-Committed Revenues (i.e. committed

prior to the Project investment decision), plus those Subsequent Revenues within point (b) (i) above (i.e. those committed during the project's work-in progress phase).

- 3.26 In addition, whilst some data licensing contacts are written with a simple \$/sqkm paid upfront, a majority of licensing contracts include deferred contingent milestone payments. Under such contingent payment contracts, the multi-client company as project owner assumes all risk of a particular event occurring – for example the data licensee succeeding in their bid to acquire or be awarded an exploration permit within the area of the survey. The deferral or layering of the potential licensing revenues in this way, increases the project owner's financial risk and reward profile, and introduces a significant exposure to the pure prospectivity or exploration risk related to that area by linking rewards to the exploration outcomes.

Operational risks as titleholder

- 3.27 As the SPA titleholder, the multi-client company is authorised by the Australian government to carry on petroleum exploration operations. As a condition of this title, the multi-client company takes ultimate legal responsibility for all operations conducted as a part of the exploration activity. The direct liability for personnel injury, damage to survey equipment and in-situ production infrastructure, environmental clean-up caused by accidental hazardous material discharge, vessel grounding, collision or loss of equipment or the vessel itself, plus any force majeure events.
- 3.28 These direct risks are also extended in certain circumstances to include substantial indirect risks, for example the risk of consequential losses incurred by a permit operator or other stakeholders in respect of any incident that may occur during the seismic survey within that operator's permit (e.g. loss of hydrocarbon production etc).
- 3.29 As noted above, although the multi-client company may receive some pre-commitment revenues and WIP revenues, these revenues do not completely offset the significant operational risks assumed by the multi-client company in conduction exploration activities offshore and the potential significant dollar value of risk exposure should operations result in an adverse incident.

Prospectivity and exploration risk

- 3.30 In funding the multi-client seismic surveys, the multi-client company seeks new exploration information to help define and find commercial hydrocarbons within the survey area. Seismic surveys make offshore energy production safer and more efficient by clarifying the geology under the sea floor, allowing interpretation of hydrocarbon prospectivity, and identification of Direct Hydrocarbon Indicators (or DHIs). This work ultimately reduces the risks for E&P companies during the highest cost phase of exploration (e.g. the drilling of wells) by identifying optimum drilling locations, and reducing the drilling of "dry holes" (where no oil or gas is found).
- 3.31 In carrying the principal exploration risk, the multi-client company adopts an exposure to all the elements of exploration and commercial risks traditionally borne by E&P companies/permit operators, as the demand for licensing the multi-client survey data is directly linked to both of the following:
- The availability of exploration acreage within the survey area; and
 - Data demand is linked to the demonstrated hydrocarbon prospectivity, including showing potential for commercial volumes (on current oil price, and assessment of all development costs & infrastructure associated with establishing production in that location).

- 3.32 The commerciality of any potential hydrocarbon resource is also dependant on the fiscal terms settings within the relevant jurisdiction. Any change to these fiscal terms impact both the economics of any potential resource development (thereby impacting the demand for exploration data) and / or the commercial return available to those companies that invest in exploration data.
- 3.33 A multi-client survey can “disastrously fail” for the multi-client company, if the survey proves the area to be not prospective by failing to identify prospects for commercial hydrocarbon recovery, or if for any reason the survey fails to provide new information to the exploration industry, e.g. poor data quality.
- 3.34 Similarly, material and adverse commercial results can eventuate for the multi-client company if after successfully imaging of the prospectivity of an area, that area subsequently becomes uneconomic due to an adverse movement in the oil price or development costs.
- 3.35 Conversely, if interpretation of the new survey identifies several direct hydrocarbon indicators suggesting significant hydrocarbon volumes exist within the area, then the multi-client Project Owner exploits that exploration success, by the multiple licensing of copies of the dataset, plus the opportunity to make additional multi-client survey investments in that location.
- 3.36 This clearly evidences the risk and reward outcomes assumed by the multi-client company in undertaking exploration in offshore areas and is consistent with the nature of activities undertaken under a SPA.

Data usage by multi-client companies

- 3.37 Multi-client companies have a continuous appetite for new exploration information, whether sourced from government, other companies, public disclosures or from their own new exploration activities. As soon as any new information is available to the teams of geophysicists and geologists within the multi-client companies, that information will be closely studied and interpreted to determine its impact on the prospectivity of the subject area and any other analogous areas e.g. where similar geologic settings exists.
- 3.38 The scope of the studies performed include the following:

Regional Basin Framework

- Sedimentary basins: classification & tectonic setting
- Regional paleogeography
- Seismic interpretation (sedimentary horizon and fault mapping)
- Regional stratigraphy/depositional environments/sequence stratigraphic framework.

Petroleum System

- Hydrocarbon source presence and quality evaluation
- Subsidence history and source rock maturation/migration (including 1D basin modelling)
- Seal presence and quality evaluation
- Trap (structural and stratigraphic) analysis
- Formation evaluation
- Reservoir presence and quality evaluation

Resource Commerciality

Prospect evaluation

Final recommendation for Block/Acreage release recommendations

- 3.39 For information generated from multi-client surveys, the use of the field tapes which contain raw seismic data obtained from the survey commences with the pre-processing phase during which the review, processing and evaluation of the data is undertaken with the view to understanding what new exploration information has been revealed and the potential for direct hydrocarbon indicators. For example, the multi-client company's own geophysicists and geologists will commence their reviews of the resultant dataset at the first de-multiple stage, highlighted in the example below as the High Resolution Radon De-multiple.
- 3.40 These reviews then continue to evaluate each new intermediate processing product created during the remainder of the Geophysical Processing and Imaging phase of the project. On completion of the final processing products, a more thorough study is made of the dataset. This process of evaluating the dataset is repeated whenever additional information relevant to that exploration area, becomes available from whatever source.
- 3.41 An example of a PreStack Dept Migration (**PSDM**) processing flow undertaken as part of the Geophysical Processing and Imaging phase is detailed below.

Pre Processing

Input navmerge SEG-Y

Low Cut Filter

Recording System Delay Correction

De-bubble

De-blend (attenuation of overlap shots)

Noise Attenuation (Swell), Trace and Shot edits

1km First Pass Velocity Analysis (VA1) with data preconditioning

Bandwidth Enhancement with Clari-Fi

Residual De-bubble and Zero-phasing

Resample to 4ms

Tidal statics and water column statics Correction

3D SRME/SWD

Amplitude Recovery

Linear Noise Attenuation

High Resolution Radon De-multiple

Q-Compensation (phase only)

Fast track processing with post stack time migration

Survey Matching (if required)

Data Binning and Regularization

Multi Domain Noise Attenuation

PSDM Velocity Model Building and post PSDM processing

- Input pre migration final demultiple gathers
- Water velocity determination
- Initial model using PSTM 2-term Vrms velocity function
- Tomography iteration 1 velocity model update
- Well calibration
- Derivation of VTI/TTI anisotropic parameters
- Tomography iterations 2 to 5 for velocity model update
- VTI/TTI Anisotropic Pres-Stack Depth Migration
- HDVA Analysis
- High Resolution Radon Demultiple
- Residual Noise Attenuation
- Residual Moveout Correction in Depth (DRMO)
- Angle Mute and Stacking
- Angle Stacks in Depth and Time - Q-Compensation (Amplitude only)
- Post Stack Scaling on Depth and Depth to Time converted data

- 3.42 As outlined above, the multi-client company is the first recipient of and user of the dataset. It uses that dataset directly in its ongoing exploration activities. Every aspect of the Geophysical Processing and Imaging phase is solely directed towards exploration and determining the presence or absence of petroleum.
- 3.43 The data copies that are distributed to the parties that have licensed the survey data, are generally distributed upon completion of the Geophysical Processing and Imaging process for those licensed data products (although certain contracts allow for data to be licenced earlier). The product distributed to clients is in such cases fundamentally different to the raw survey data initially obtained by the multi-client company.
- 3.44 On receipt of the data deliveries, the licensed E&P companies will then commence their own review of the enhanced dataset. Although that licensee will have a first use of the dataset copy, that first use will be after the use of the data by the multi-client company.
- 3.45 Importantly, it is noted that any new information discovered during the course of the Geophysical Processing and Imaging process, is of immediate benefit to the multi-client company's business, both in supporting promotion of data licensing sales, and in furthering new survey investment planning within the survey area, immediately adjacent areas, and any analogous areas.
- 3.46 In addition, any new exploration information is used by the multi-client company to identify and then present a proposal of new prospective exploration areas that may be adopted by the relevant government authority for the next round of new block releases available for public bidding process.

4. Taxable income under TR 2017/D11 principles

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5. Immediate deduction for exploration

- 5.1 As noted in the introduction to this submission, the key focus of this submission is the application of the exploration provisions, and specifically section 40-80.
- 5.2 The IAGC submits that an immediate deduction should be available to the multi-client company as exploration under section 40-80 to the extent that the expenditure incurred is capital in nature.
- 5.3 These exploration provisions must be applicable to multi-client companies on the basis that:
- 5.3.1 Exploration activities that have traditionally undertaken by E&P companies are now undertaken by the multi-client industry. This has been a transition of the entire exploration function, including prospectivity review, risk and reward which are now effectively out-sourced to multi-client companies who undertake these activities in their own right.
- 5.3.2 The traditional contractor services model is entirely different to that of the multi-client business and should not be used as a simple proxy for defining the activities or role of the company when undertaking multi-client activities.
- 5.3.3 An MPQI comes into existence upon the acquisition of the seismic data and the existence of that data in its raw form. The multi-client company uses that raw form data to analyse, process and delineate areas of prospectivity and therefore uses it for exploration.
- 5.4 For completeness, it is noted that although the following discussion focuses primarily on section 40-80, the outcomes should equally apply for the purposes of section 40-730. For example, section 40-730 remains relevant for those activities as part of the prospectivity review that do not form part of the cost of a depreciating asset (to the extent they are capital in nature).

Application of section 40-80 and consideration

- 5.5 As the ATO is aware, section 40-80(1) provides an immediate deduction for the cost of a depreciating asset that is 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.
- 5.6 Section 40-80(1) specifically applies where the following conditions are met (emphasis added):
- (a) You first use the asset for exploration or prospecting for minerals, or quarry materials, obtainable by mining and quarrying operations.**
- (b) When you first use the asset, you do not use it for:**
- (i) Development drilling for petroleum; or**
 - (ii) Operations in the course of working a mining property quarrying property or petroleum field; and**
- (c) You satisfy one or more of these subparagraphs as the asset's start time**
- (i) You carry on mining and quarrying operations; or**
 - (ii) It would be reasonable you proposed to carry on such operations; or**
 - (iii) You carry on a business of, or a business that included, exploration or prospecting for minerals or quarry minerals obtainable by such operations, and expenditure on the asset was necessarily incurred in carrying on that business; and**

(d) *In a case where the asset is a mining quarrying or prospecting right – you acquired it from an Australian government agency or a government entity.*

(e) *In a case where the asset is mining quarrying or prospecting information:*

- (i) *You acquired the asset from an Australian government agency or a government entity;*
- (ii) *The asset is a geophysical or geological data package you acquired from an entity to which subsection (1AA) applies; or*
- (iii) *You created the asset, or contributed to the cost of its creation; or*
- (iv) *You caused the asset to be created, or contributed to the cost of it being created, by an entity to which subsection (1AA) applies.*

5.7 In considering the detailed requirements of section 40-80, the IAGC fundamentally disagrees with the ATO's position in TR 2017/D11, in respect to the following:

5.7.1 In respect of the application of section 40-80(1)(a), and whether the asset is first used by the multi-client company for exploration or prospecting for minerals, or quarry materials, obtainable by mining and quarrying operations;

5.7.2 In respect of section 40-80(1)(c)(iii), and whether the multi-client company meets the legislative requirement that it carries on a business that includes exploration or prospecting for minerals obtainable by such operations.

5.8 Each of these specific matters is discussed in further detail below, with particular regard to the wording of the exploration provisions in the tax law, any relevant policy guidance (or absence of such guidance) and the ATO's views as expressed in related public rulings and other materials.

First use for exploration or prospecting

5.9 In considering whether an asset is first used for exploration or prospecting, the ATO has long applied the principle (in the context of intangible mining, quarrying or prospecting rights) that the inherent nature of the asset must be used or exploited by the taxpayer in order for the asset to be used.

5.10 In the case of seismic MPQI obtained by the multi-client company, the IAGC submits that an MPQI exists when the data is obtained in raw data form by way of field tapes. At this stage, the raw data contains information as to the presence or absence of minerals / petroleum and is an asset that is capable of being traded or sold.

5.11 The multi-client company's activities in using the data as outlined at section 3 (paragraphs 3.37 to 3.46) of this submission during the Geophysical Processing and Imaging phase clearly demonstrates that once the raw seismic data is obtained by the multi-client company, it is reviewed, processed and evaluated by the multi-client company. These activities are specifically undertaken for the purposes of searching, evaluating and delineating the presence or absence of any direct hydrocarbon indicators. The work is undertaken by the multi-client company, including geologists and geophysicists and the Geophysical Processing and Imaging phase can take between 4 and 18 months to complete (as per the timeline outlined in table 3.9).

5.12 The ATO's views at paragraph 42 that the multi-client company does not use the data because its activities consist of "*gathering the MPQI for others to use*", is therefore incorrect for the following reasons:

5.12.1 The ATO's position ignores the fact that the multi-client company uses (as required by the section itself) the data in its own right for the purposes determining the presence, absence or extent of petroleum in the area subject to the survey (i.e.

direct hydrocarbon indicators). This is specifically done in order to improve the monetisation of the data and therefore is for the benefit of the multi-client company.

- 5.12.2 The ATO's position is taken on the basis of assuming that the multi-client business is limited to the activities outlined at paragraph 12 of the TR, which would by themselves, indicate that the activities are a service provided to E&P companies. However, this ignores the wider multi-client business model outlined in detail at paragraph 3.1 to 3.8 of this submission. When this wider business model is considered, the evidence clearly demonstrates that a multi-client company undertakes actual exploration activities using the MPQI on its own account.
- 5.12.3 The ATO's position is inconsistently expressed throughout the ruling. For example, paragraph 36 of TR 2017/D11 states the multi-client company holds the asset *"through possession, ownership and use of the data as soon as the seismic survey has been conducted"*. The IAGC agrees with the principles of paragraph 36, although for completeness, the IAGC notes that possession, ownership and use of the data will occur during stages of the seismic survey where data becomes available, and not simply on completion of the seismic survey.
- 5.13 The scale and volume of processing and work undertaken by the multi-client company in respect of the information demonstrates that the MPQI is "used" by the multi-client company. Because that use of the data is for the purposes of determining direct hydrocarbon indicators, the IAGC submits that the ATO must accept that the data is first used for exploration.
- 5.14 Importantly, the multi-client model is fundamentally different from that of a standard services contract where the company collects data on behalf of their client as demonstrated by the above industry discussion at paragraphs 3.12 and 3.13 of this submission.
- 5.15 In the case of multi-client data, the initial use of the MPQI asset is by the multi-client company and is clearly with the express purpose of exploration. The only difference between the activities undertaken by a multi-client company and an E&P company undertaking exploration is that a multi-client company does not generally engage in any subsequent exploration drilling (a finding that is not required by the law to exist before eligibility is obtained).

Business of exploration or prospecting

- 5.16 The IAGC submits that the statements made by the ATO at paragraph 45 of the TR that *"the business of the multi-client company is as a provider of geophysical surveys on behalf of others"* is incorrect. The IAGC also refutes the ATO's further statements at paragraph 45 that despite geophysical surveys being expressly listed as "exploration" that *"it does not follow that the multi-client company carries on a business of exploration or prospecting"*.
- 5.17 The IAGC submits that the wording of the legislation is inherently clear and expressly provides that geophysical surveying *is* exploration or prospecting.
- 5.18 That is, the requirements of subsection (c)(iii) state the following:
- "You carry on a business of, or a business that included, exploration or prospecting for minerals or quarry minerals obtainable by such operations, and expenditure on the asset was necessarily incurred in carrying on that business."*
- 5.19 The IAGC submits that this requirement is clearly met by the multi-client company on the basis that the multi-client company carries on a business that includes "exploration or

prospecting” as *that term is defined* for petroleum which is obtainable by mining operations (of others).

- 5.20 The IAGC submits that the expenditure on obtaining and processing the data is incurred in carrying on a business that includes “exploration or prospecting” on the basis that the definition of exploration takes on its ordinary meaning, but is also further expanded to include the matters specifically listed in paragraphs 40-730(4)(a) to 40-730(4)(d) which include:

“(b) for petroleum mining:

- (i) geological, geophysical and geochemical surveys; and
- (ii) exploration drilling and appraisal drilling;”

- 5.21 On the basis that the multi-client company undertakes geophysical surveying as part of its business on its own account (and not as a subcontractor for another party) for the purposes of multi-client surveys, the multi-client company should be considered to meet the requirements of subsection 40-80(1)(c)(iii) .

- 5.22 This position is expressly supported by the ATO’s interpretation of the term “exploration and prospecting” as outlined in Taxation Ruling TR 2017/1: Income tax: deductions for mining and petroleum exploration expenditure at paragraphs 35 to 37 including that:

“35. The form of the definition of EorP in subsection 40-730(4) allows the expression to include its ordinary, natural meaning. That meaning is the discovery and identification of the existence, extent and nature of minerals and 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.

... and

37. The matters specifically listed in paragraphs 40-730(4)(a) to 40-730(4)(d) are express additions that are expansive of the ordinary meaning and are not conditioned by it. They are satisfied if the activity meets the legislative description whether or not it is exploration or prospecting in the ordinary sense of those words. For example, geological mapping is EorP as defined in paragraph 40-730(4)(a) even if it is undertaken as part of extractive operations. In such a situation, deductibility of expenditure on such mapping would depend upon a consideration of the other conditions in subsection 40-730(1) (for example, it must be ‘for minerals etcetera.’) and the exclusions from deductibility under that subsection, such as those in subsection 40-730(2).”

- 5.23 The IAGC further submits that there is no specific nexus required in the section between the exploration business undertaken by the multi-client company and any further exploitation of the resource by the multi-client company in its own right.

- 5.24 We submit that there is no express language in the legislation in section 40-80 or the definition of exploration or prospecting in section 40-730 that requires the entity conducting the exploration business to be the same entity that undertakes (or is able to undertake) mining or prospecting operations to exploit the resource in its own right. That is, subsection (c)(iii) expands the requirements of (i) and (ii) to extend to companies that conduct only exploration activities (but not mining operations or proposed mining operations in their own right).

- 5.25 In particular, we specifically note that section 122J (the predecessor to Division 330 and sections 40-80 and 40-730) was specifically amended in 1991 to allow deductions for broad

acreage exploration where a title or permit was not held. The explanatory memorandum to *Taxation Laws Amendment Bill (No. 3) 1991* which implemented those changes stated:

"The general mining exploration or prospecting provision will be amended to remove the requirement that mineral exploration or prospecting expenditure need be incurred on a mining tenement to qualify for immediate deductibility.

This will allow expenditure incurred in exploring broad areas not covered by a mining tenement to be deductible."

5.26 And further:

"The amendment will put all exploration or prospecting expenditure on the same footing, whether it be to quarrying, to petroleum operations or to other mining operations."

5.27 It is clear from the language in the explanatory memorandum that at the time of implementing these amendments, the purpose of the changes was to align the petroleum and mining exploration provisions in Divisions 10AAA and 10A respectively and to ensure that the ability to claim exploration deductions was allowed for the "grass roots" stage of exploration programs which were undertaken over very large areas and before any mining tenements were required. Importantly such exploration did not require the consent of the holders of any mining tenements within those areas or need to be undertaken by such holders.

5.28 Therefore, having regard to these amendments, we submit the ATO cannot now seek to impose a nexus or requirement for the explorer to hold or seek to hold a petroleum licence in order for the provisions of section 40-80(1)(c)(iii) to apply.

5.29 Given that multi-client companies conduct exploration (typically geophysical surveys) over broad acreage as an essential part of their business activities, the fact that a SPA title does not confer drilling or exploitation rights has no relevance in whether the activities should qualify for deduction as exploration or prospecting.

5.30 In this respect, the IAGC submits that the ATO should have specific regard to the explicit definition of "explore" under section 19 of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* as it applies to Special Prospecting Authorities held by the multi-client companies which states that:

(1) *For the purposes of this Act, if:*

(a) *a person:*

(i) *carries out a seismic survey, or any other kind of survey, in an offshore area; or*

(ii) *takes samples of the seabed or subsoil of an offshore area; and*

(b) *the person does so with the intention that the person or another could use the survey data, or information derived from the samples, as the case may be, for the purpose of discovering petroleum;*

*the person is taken to **explore** for petroleum. (emphasis added)*

5.31 Furthermore, as demonstrated through the detailed industry analysis outlined in section 3 above and the specific terms of the SPA granted under the *Offshore Petroleum & Greenhouse Gas Storage Act 2006*, the exploration activities conducted by multi-client companies are undertaken at significant commercial risk. This is consistent with the SPA licence granted by the Australian Commonwealth Government which provides that the multi-

client company (as the registered holder of the SPA) undertakes exploration activities (other than drilling) in its own right.

- 5.32 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.*

- 5.33 Therefore, from a policy perspective, multi-client companies which hold an SPA which is a licence to explore granted by the Australian Government should be entitled to equal treatment in claiming deductibility for that exploration expenditure, as afforded to other participants within the petroleum exploration industry.

- 5.34 This would be consistent with existing policy practice which provides:

- 5.34.1 Junior explorers with an immediate deduction under section 40-80 having regard to the reasoning applied in ATO ID 2011/25;
- 5.34.2 E&P companies with an exploration deduction for mining information acquired over an area prior to obtaining a title;
- 5.34.3 MCL companies a deduction for exploration to the extent they form part of a consolidated group which otherwise carries on mining operations;
- 5.34.4 E&P companies with an exploration deduction for mining tenements and information acquired under a deferred farm-in arrangement where title has not yet been transferred as discussed in the Miscellaneous Taxes MT 2012/2; and
- 5.34.5 Allows for the operation of the exploration and prospecting provisions in the context of other aspects of the law (e.g. 23AH and CFC provisions).

- 5.35 The IAGC submits that applying the immediate deduction available under section 40-80 to the expenditure incurred is also 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*, which states (emphasis added):

“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.

- 5.36 In this respect, the IAGC specifically notes that there is nothing in the wording of the legislation itself that would require a degree of risk to be undertaken in order for expenditure to qualify as exploration and for a company to be considered to be carrying on a business of exploration. The IAGC is of the view that the legislation and policy is focused on the activities undertaken by the parties having regard to the substance of the arrangements, and the nexus of those activities to exploration, rather than the contractual risks assumed by the parties.
- 5.37 However, recognising the ATO's position on the matter of exploration risk, the IAGC points to incorrect statements made by the ATO at paragraph 47 that because pre-funding or pre-commitment revenues are secured, before making a decision to proceed, the risk-reward profile is unlike that of a miner or "junior explorer". As noted in detail at paragraph 3.25 above, references to pre-funding in the IAGC's submission dated 22 September 2017 of 70% to 100% of project costs were made to revenue including those derived after an investment decision is made but during the work-in-progress period. This is not representative of the level of pre-funding or pre-commitment at the time of making the investment decision to proceed with a multi-client survey. As noted at section 3.15, there are also a variety of business decisions and profiles taken by multi-client companies and each is evaluated separately in determining whether to proceed with a multi-client survey.
- 5.38 Accordingly, as demonstrated in the industry discussion at section 3 to this submission, under the multi-client business model, the multi-client company initiates and conducts projects of seismic survey (which meets the definition of exploration or prospecting for minerals) at its own financial/operational and prospectivity risk. That is, the multi-client seismic surveys bear a high exploration risk with the financial outcome dependent on the exploration potential discovered.
- 5.39 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.
- 5.40 It is therefore the IAGC's view that ATO ID 2011/25 provides support that multi-client companies that bear the economic risk of the exploration results should be eligible for a deduction under section 40-80.

- 5.41 Finally, in considering these matters, we also note the ATO's views as expressed in Taxation Ruling TR 2017/1: Income tax: deductions for mining and petroleum exploration expenditure regarding exploration and prospecting expenditure and specifically at paragraph 147 that:

*“147. In Commissioner of Taxation v. Bargwana (**Bargwana**) Edmonds J explained that concessions such as those given to the mining industry, such as that for EorP, are to be given a liberal rather than a narrow construction and application.*

28. It can be accepted that where Parliament has enacted legislation to encourage a particular activity, for example, legislation which gives particular concessions to the mining or petroleum industries, the legislation must be construed so as to promote Parliament's purpose and not so as to detract from that purpose: Totalizator Agency Board v. Commissioner of Taxation 96 ATC 4782; (1996) 69 FCR 311 at 323A per Hill J, with whom Tamberlin J and Sundberg J agreed. Thus an exemption which exists for the purpose of encouraging, rewarding or protecting some class of activity is to be given a liberal rather than a narrow construction and application: see Commissioner of Taxation v. Reynolds Australia Alumina Ltd 87 ATC 5018; (1987) 18 FCR 29 at 35 per Beaumont J and at 46 - 47 per Burchett J; Diethelm Manufacturing Pty Ltd v. Commissioner of Taxation 93 ATC 4703; (1993) 44 FCR 450 at 457 per French J.”

- 5.42 The law governing offshore petroleum exploration (under the *Offshore Petroleum and Greenhouse Gas Storage Act 2006*) recognises that multi-client activities under an SPA are *exploration*. The above interpretation in *Bargwana* means that the tax treatment of multi-client exploration should be the same as that afforded to other exploration activities. The ATO in their draft TR have sought to adopt a narrower view than the liberal approach prescribed by *Bargwana* and outlined in TR 2017/1, and in the view of the IAGC, there is no policy to support such a distinction.

Concluding remarks

- 5.43 With the evolving nature of the exploration and resources industries, multi-client companies have taken on the traditional exploration functions of resource companies, thereby taking on significant risk in their own right to explore and generate new exploration information.
- 5.44 Accordingly the IAGC submits that the nature of the activities undertaken by multi-client is sufficient to:
- 5.44.1 Meet the requirements of section 40-80(1)(a) that the MPQI is first used by the multi-client company for exploration; and
 - 5.44.2 Meet the requirements of section 40-80(1)(c)(iii) that the multi-client company carries on a business of exploration or prospecting for minerals obtainable by such operations.
- 5.45 On this basis, the IAGC submits that if the MPQI expenditure is considered to be capital in nature, then all requirements of section 40-80(1) can be satisfied in relation to multi-client seismic data and therefore the cost of the depreciating asset, being the MPQI will be immediately deductible.

6. Capital vs. revenue characterisation

Application of “advantage sought” and “enduring benefit” principles

- 6.1 The IAGC welcomes and recognises that the ATO has sought to provide detail of relevant case law in the Explanation and the Alternative Views sections of the TR regarding the characterisation of expenditure as capital or revenue. Having said that, the IAGC believes the ATO has selectively chosen certain general principles of case law dealing with the revenue/capital distinction and sought to apply these to limited activities of the multi-client business (with particular reference to those activities listed at paragraph 13) without due regard to the intention, motivation or purpose of the taxpayer in undertaking multi-client activities.
- 6.2 Specifically, the IAGC believes that the ATO has failed to consider the following key principles of case law as they apply to the circumstances of a multi-client company:
- 6.2.1 *“The manner in which expenditure it is to be enjoyed”, as formulated in *British Insulated & Helsby Cables Ltd v Atherton*⁵; and*
- 6.2.2 *What the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process...” as outlined in *Hallstroms Pty Ltd v FCT*⁶.*
- 6.3 As noted in section 4 to this submission, the average revenue profile of multi-client companies clearly evidences the commercial purpose of incurring expenditure is to generate immediate revenue returns through the marketing and licence of the information. The revenue profile proves that:
- 6.3.1 An enduring benefit to the multi-client company does not exist. The concept of enduring benefit as proposed by the ATO in the TR only arises upon a narrow focus of the legal form of the arrangement and an asset being created. Although framed as a data licence arrangement, the true practical business relationship between the multi-client company and the E&P company, is effectively a sale of the information with restrictions governed by the licence agreement.
- 6.3.2 Any exploration potential that is identified by the multi-client company is evaluated immediately and used to maximise immediate sales of the data to E&P companies. There is generally limited ability to monetise the data after the initial sale/licence of the data. This is again evidenced by the revenue profile and pattern shown.
- 6.4 Having regard to the above, the IAGC disagrees with the ATO application of the principles of “advantage sought” and “enduring benefit” which is used to treat MPQI expenditure (including all those expenditure classes listed at paragraph 13 of the ruling) as being capital in nature purely on the basis that an asset is created and licenced under legal form.
- 6.5 This narrow view of the activities of the taxpayer fails to recognise that in determining the “advantage sought” that:
- 6.5.1 The practical and business effect of expenditure incurred in undertaking one (of many) multi-client surveys is that it is in the ordinary course of business of deriving revenue and therefore the expenditure is incurred on revenue account;
- 6.5.2 The sustainability of the multi-client business is dependent upon an evolving data library whereby data is constantly acquired, processed, reprocessed and licenced

⁵ (1925) All ER 623

⁶ (1946) 72 CLR 634

and therefore the costs of obtaining data is recurring expense of the multi-client company and therefore revenue in nature; and

- 6.5.3 Although the multi-client company retains a proprietary interest in information and enters into restricted data licenses with individual E&P companies, the practical, business and economic effect of the transaction is that, it is essentially the sale of data with restrictions on the E&P company, which acquires the information and cannot on-sell or otherwise deal with it.
- 6.6 The IAGC further submits that while the information may have some short term benefits, it cannot be regarded as having an “enduring benefit” (i.e. capital in nature) on the basis that:
- 6.6.1 The data licencing generates revenues on the upfront licencing with most revenue being generated prior to the data set being completely processed. Subsequent revenues are highly contingent. 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.
- 6.6.2 Exclusivity cannot necessarily be maintained given that the SPA 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 multi-client company 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 undertaken over the same area by competing multi-client companies at different times and using different technologies.

Application of specific case law

- 6.7 The IAGC notes that the ATO has sought to distinguish certain other case law in its Alternative Views section of the TR, including:
- *BP Australia Ltd v Federal Commissioner of Taxation (1965) 112 CLR 386 365;*
 - *National Australia Bank v Commissioner of Taxation (1997) 80 FCR 352; and*
 - *Commissioner of Taxation v Ampol Exploration Limited (1986) 13 FCR 545;*
- 6.8 The IAGC continues to be of the opinion that each of these cases demonstrate that in circumstances where the Courts have looked to apply the revenue versus capital distinction to the detailed and specific facts of a taxpayer’s business model, the Courts will treat certain costs that may appear as prima facie capital or enduring in nature as being on revenue account. A further detailed analysis of each of these cases is outlined in the IAGC’s previous submission dated 22 September 2017.
- 6.9 The IAGC submits that it is the industry’s view that having regard to the specific facts and circumstances of the multi-client business model, that the costs of obtaining data are incurred in carrying on a business and, that the collection of the data is an ordinary and recurrent expense necessary for the purposes of deriving revenue under the multi-client business model.
- 6.10 Therefore the IAGC submits that the ATO should accept that expenditure incurred in obtaining the data is able to be deductible under section 8-1 as being inherently revenue in nature.
- 6.11 The IAGC also submits that the position outlined in the TR is unnecessarily binary and does not take into account the diversity of the multi-client business models adopted by the



industry as outlined in paragraph 3.15 above including the level of pre-funding, participants and risk profiles.

- 6.12 The IAGC submits that each industry participant should therefore be able to self-assess their own tax treatment of costs as revenue or capital in nature, based on their specific set of facts and circumstances.
- 6.13 Accordingly the IAGC requests that the ATO consider whether the draft TR in its current form (and absolute application to the industry) is appropriate given the range of factual circumstances and the breadth of relevant case law.

7. Trading stock

7.1 While the IAGC submits that its primary positions are that the expenditure incurred is immediately deductible as exploration under section 5 of this submission or on the basis that it is revenue in nature under section 6 of this submission, the IAGC also submit that the nature of the multi-client licencing arrangement is 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.

7.2 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.⁷ In these circumstances, the tax characterisation of 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.⁸

7.3 If the ATO continues to apply a narrow view of the multi-client business defined by the licence arrangements, as per paragraph 24 of the TR which states that:

“From a practical and business point of view, you incur the expenditure to create or add to a library of seismic data to be licensed for profit to your clients. The data is an asset of value to you, as it is protected by your licensing agreements, including the non-disclosure clauses, and you exploit it by deriving income in the form of licence fees”

then the IAGC submits that the treatment of seismic data costs *must be* consistent with the treatment afforded by the ATO for an extended period (i.e. since 1993) to computer software that is licenced for simple use or sale.

7.4 Specifically, paragraph 7 of the Ruling section of TR 93/12 clearly states that:

“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”. [emphasis added]

7.5 We disagree with the inferences made by the ATO in paragraph 81 that because the multi-client company does not “buy, re-sell, distribute or sub-licence its licences”, that the same treatment should not be afforded as in TR 93/12.

7.6 Paragraph 7 of 93/12 makes no reference to the developer needing to be an intermediary distributor that acquires and resells data. The ruling paragraph clearly states that if software is developed for licence and the developer carries on a business of trading in such licences, then the licences are trading stock.

7.7 By extension and clear parallel, where MPQI is developed for licence and the developer (i.e. multi-client company) carries on a business of trading in MPQI licences, then the licences must be considered to be trading stock.

⁷ See the ATO's ruling, TR 93/12 – Income tax: computer software

⁸ Refer to the Commentary on the OECD Model Tax Convention on Income and on Capital (2014), Commentary on Article 12, paragraphs 12-15.

8. Balancing Adjustments

- 8.1 Notwithstanding the key issues highlighted in sections 5, 6 and 7 of this submission, the IAGC welcomes the endeavor made by the ATO in its Compliance Approach in the TR in identifying the asset and the asset's use for the purposes of determining a balancing adjustment.
- 8.2 However, the IAGC submits that there is a fundamental error in the drafting of paragraph 56 of the Compliance Approach section, being the statement that *"the data component stops being used at the earliest time when there is no longer a licence agreement that covers it, providing that the data component is not put to any other use"*.
- 8.3 From discussions with ATO during the consultation process, it was understood that there would be proposed compliance guidelines that would allow a balancing charge event to occur prior to the publication of data (i.e. prior to 15 years) where the asset is "impaired".
- 8.4 The IAGC submits that the current drafting of paragraph 56 of the TR, if maintained, will eliminate any ability for a multi-client company to obtain a balancing adjustment in the event that any licence is secured for the data, as there will then always be a licence agreement in place, precluding the multi-client company from applying the principles in paragraphs 55 to 59.
- 8.5 The IAGC submits that this cannot be the intention of the Compliance Approach outlined in the TR and submits that the multi-client company does not itself "use" the data once licenced, rather the entity in possession (i.e. the E&P company) may (or may not) "use" the data.
- 8.6 Once the multi-client company has exhausted all opportunity to further use the data (irrespective of licence agreements in existence) and has no further expectation of additional sales contracts, deliveries, reprocessing or re-evaluation the data (e.g. determined by reference to forecast of new licensing commitments and internal prospectivity reviews) then in accordance with the principles outlined at paragraph 58 of the draft TR, the multi-client company will have effectively ceased to use the data. It should therefore not be precluded from claiming a balancing adjustment merely because of the existence of a licence (which is akin to a historical sale). Any further use of the data under the licence at this stage is use only by the E&P company.
- 8.7 This is analogous to the situation where a taxpayer holds legal title to an asset but has ceased to use it and therefore can take a balancing adjustment notwithstanding that they still retain ownership of the asset.
- 8.8 The IAGC submits that paragraph 56 must be re-drafted to ensure it provides clarity that the existence of a licence agreement for the data does not affect the multi-client's ability to claim a balancing adjustment having regard to the principles in paragraph 58.

Appendix A Specific submission points

This Appendix contains a detailed list of all the specific submission points noted by the IAGC, which have been cross-referenced to the relevant paragraphs of TR 2017/D11 and supported by the additional detail contained in the body of this submission.

Table A: Detailed listing of all submission points

ATO Statement as per draft TR 2017/D11	IAGC Comments
<p>Paragraph 14 <i>BBSC enters into non-exclusive licensing arrangements with multiple clients who wish to evaluate accumulations of oil and gas reserves. BBSC licenses sections of its seismic data for an extended period, typically 25 years, in return for licence fees. The fees may be payable upfront or in specified instalments, depending on the contract. BBSC retains ownership of the copyright and other intellectual property in the seismic data and can deal with it in whatever way they wish. The seismic data is proprietary to, and a trade secret of, BBSC. If, during the licence period, a licensee obtains a title (or interest in a title) within the survey area permitting the licensee to extract oil or gas, it must pay BBSC additional fees.</i></p>	<p>The example is misleading and does not factually describe the typical industry activities and norms, in particular the reference to payments by instalment and the inference of a 25 year revenue stream is not correct.</p> <p>The data licensing fees committed to be paid under the majority of data license contracts become payable fully upfront, immediately on delivery of the licensed products to the licensee.</p> <p>When a data license contract is entered into prior to the completion of the survey acquisition and data processing, in those cases it is common for the committed license fees to be payable in instalments during the survey acquisition and data processing period, with the final instalment typically payable upon delivery of the data.</p> <p>In very limited cases, a deferred payment regime may be entered into to assist a licensee who is unable to pay all committed license fees by the delivery of the data (e.g. to bridge into a subsequent year's budget).</p> <p>License fees are not typically time based (e.g. annual instalments).</p> <p>In addition to committed license fees, under some contracts additional contingent payments may become payable upon subsequent events (e.g. licensee obtaining title to an exploration permit in the area of the survey, or the drilling of an exploration well). These are not committed payments until the subsequent event occurs.</p>

ATO Statement as per draft TR 2017/D11	IAGC Comments
<p>Paragraph 18 When the final Ruling is issued, it is proposed to apply both before and after its date of issue.</p>	<p>The TR must be prospective in application from the finalisation of the ruling, if the final published ruling results in an outcome which is adverse as compared to that which would have arisen if the principles in the TR 93/12, dealing with software licences were adopted. Refer to paragraphs 2.9 to 2.12 of this submission.</p>
<p>Paragraph 24 From a practical and business point of view, you incur the expenditure to create or add to a library of seismic data to be licensed for profit to your clients. The data is an asset of value to you, as it is protected by your licensing agreements, including the non-disclosure clauses, and you exploit it by deriving income in the form of licence fees.</p>	<p>The practical and business effect of expenditure incurred in undertaking one (of many) multi-client surveys is exploration in the ordinary course of business. The sustainability of the multi-client business is dependent upon an evolving data library whereby data is constantly acquired, processed, reprocessed and licenced and therefore the costs of obtaining data is a recurring expense of the multi-client company and revenue in nature. Refer paragraphs 6.1 to 6.5.</p>
<p>Paragraph 25 Further, it is an asset from which you derive an enduring benefit, as evidenced by the length of the licensing agreement terms negotiated: typically 25 years. It is of central importance to your business and an inextricable part of the 'structure or organization set up or established for the earning of profit'.</p>	<p>An enduring benefit to the multi-client company does not exist. The concept of enduring benefit only arises upon a narrow focus of the legal form of the arrangement and an asset being created. Refer to paragraphs 6.1 to 6.5 of this submission.</p>
<p>Paragraph 29 By contrast, you retain ownership of the copyright and other intellectual property in the seismic data, which is proprietary to you and is a trade secret of yours. You do not 'trade' in the seismic data you created by passing ownership of it to your clients. Therefore, it is not trading stock.</p>	<p>The multi-client company carries on a business of exploration. However, if the ATO maintains its views that the legal form of the data licence arrangements represents the core business model of the multi-client company, then the multi-client company must be held to be trading in data licences and the trading stock provisions must apply to the costs to obtain data that is licenced. Refer to section 7 of this submission.</p>
<p>Paragraph 36 Once you have conducted a seismic survey of an area, you have the relevant MQPI through possession, ownership and use of the data. However, item 8 does not apply to the MQPI because you do not carry on the type of operations or business mentioned in that item. You therefore hold the MQPI under item 9 while it is not generally available.</p>	<p>Item 8 applies on the basis that the multi-client company carries on a business of exploration or prospecting for minerals obtainable by such operations, as required by section 40-80(1)(c)(iii). Refer to paragraphs 5.16 to 5.42 of this submission.</p>

ATO Statement as per draft TR 2017/D11	IAGC Comments
<p>Paragraph 37</p> <p>Once the data becomes generally available, you cease to hold the MQPI under table item 9 in section 40-40 and a balancing adjustment event occurs for that data under paragraph 40-295(1)(a).</p>	<p>A balancing adjustment may also occur at an earlier point in time where the asset ceases to be used for any purpose or it is expected never to be used again. Refer to section 8 of this submission.</p>
<p>Paragraph 42</p> <p>However, you do not satisfy the 'first use' requirement because your activities consist of gathering the MQPI for others to use. You do not use the MQPI in your own right for exploration or prospecting for minerals, etcetera obtainable by mining and quarrying operations.</p>	<p>The multi-client company undertakes processing of the information in its own right for the purposes of determining direct hydrocarbon indicators, The multi-client company therefore first uses the MPQI for exploration. Refer to paragraphs 5.9 to 5.15 of this submission.</p>
<p>Paragraph 45</p> <p>As for the second condition, although one of the activities listed in the definition of 'exploration or prospecting' is 'geophysical surveys', it does not follow from this that you carry on a business of exploration or prospecting. Your business is a provider of geophysical surveys on behalf of, or for the benefit of, others.</p>	<p>Section 40-80(1)(c)(iii) is clearly met by the multi-client company on the basis that the multi-client company carries on a business that includes "exploration or prospecting" as that term is defined for petroleum which is obtainable by mining operations (of others). Refer to paragraphs 5.16 to 5.42 of this submission.</p>
<p>Paragraph 46</p> <p>The basis of the concessional treatment of exploration or prospecting expenditure is the inherent uncertainty and economic risk involved in obtaining rewards from the exploitation of the results (minerals) discovered through conducting the exploration or prospecting activities. While there is no guarantee that your activities will find any mineral deposits, or that they will be commercially exploitable, your clients bear that economic risk, not you. Your risk is that you will not be able to cover the costs of undertaking a survey from licensing the resulting data.</p>	<p>There is nothing in the wording of the law that requires consideration of the economic risk of the company undertaking exploration activities. That said, the multi-client seismic company bears a high exploration risk with the financial outcome dependent on the exploration potential discovered. Refer to paragraphs 3.14 to 3.46 and 5.36 to 5.42 of this submission.</p>
<p>Paragraph 47</p> <p>You would typically mitigate this risk by securing pre-funding or pre-commitments for all, or a majority, of the costs of the survey before making an investment decision to proceed with the survey. In this respect, your risk-reward profile is unlike that of a miner, or even that of a so-called 'junior explorer'.</p>	<p>References to pre-funding in the IAGC's submission dated 22 September 2017 of 70% to 100% of project costs were made to revenue including that derived after an investment decision is made but during the work-in-progress period. This is not representative of the level of pre-funding or pre-commitment at the time of making the investment decision to proceed with a multi-client survey. Refer to paragraph 3.25 of this submission.</p>

ATO Statement as per draft TR 2017/D11	IAGC Comments
<p>Paragraph 48</p> <p>Therefore, we consider that you do not satisfy the second condition in paragraph 43 of this draft Ruling either. Since the conditions in section 40-80 are not met, it does not apply.</p>	<p>All requirements of section 40-80 are met and therefore this provision will apply to the extent multi-client costs are capital in nature and form part of the cost of a depreciating asset. Refer to discussion at section 5 of this submission.</p>
<p>Paragraph 49</p> <p>Subsection 40-730(1) allows you to deduct expenditure incurred in an income year on exploration or prospecting for minerals, or quarry materials, obtainable by mining and quarrying operations, subject to conditions which are for all practical purposes identical to those set out in paragraph 40-80(1)(c) (see paragraph 43 of this draft Ruling). Those conditions are not satisfied in your circumstances (see paragraphs 44 to 48 of this draft Ruling), and so neither are the conditions in subsection 40-730(1).</p>	<p>For the reasons outlined in respect of section 40-80, the requirements of section 40-730 would equally be met. For example, section 40-730 remains relevant for those activities as part of the prospectivity review that do not form part of the cost of a depreciating asset (to the extent they are capital in nature).</p>
<p>Paragraph 55</p> <p>The start time of each data component is when you first 'use' it. In practice, this would be when a copy of the data component is first delivered under the earliest licence agreement entered into for that data component. This is the moment following creation of the MQPI when you first use the data to meet your obligations as a licensor under the licensing agreement. The processing and analysis of the raw data would have had to be completed to a standard required under the licence agreement before this 'use' takes place.</p>	<p>The multi-client company first uses the raw data as part of the Geophysical Processing and Imaging process for the purposes of determining the existence of direct hydrocarbon indicators. The use of the data by the multi-client company is not defined by the existence of licencing arrangements. Refer to paragraphs 3.37 to 3.46 and 5.9 to 5.15 of this submission.</p>
<p>Paragraph 56</p> <p>The data component stops being used at the earliest time when there is no longer a licence agreement that covers it, providing that the data component is not put to any other use. If, at this time, you expect never to license the data component again, or otherwise use it for any purpose, a balancing adjustment event happens.</p>	<p>A balancing adjustment event should occur in the year that there is no further use of that survey data either from internal prospectivity reviews or via forecast of new licensing commitments. The balancing adjustment should be allowed regardless of whether there are existing licences in place. The multi-client company's use of the data is not dependent on existing licencing arrangements. Only the E&P company could be considered to continue to use the data under terms of the licence. Refer to section 8 of this submission.</p>

ATO Statement as per draft TR 2017/D11	IAGC Comments
<p>Paragraph 62</p> <p>If you resurvey an area you have already surveyed, you must consider whether the new survey gives rise to a new data component (depreciating asset) for the area, or an improvement to the data component you already hold for the area. In the latter case, the cost of the improvement forms part of the second element of the cost of the existing data component.</p>	<p>A more appropriate example would be to consider the re-processing rather than the re-survey of data. Although resurveying an area may occur in some circumstances, this is relatively uncommon and a more appropriate example would be the re-processing of data which is undertaken more frequently than resurveying.</p>
<p>Paragraph 81</p> <p>It has been contended that this treatment is inconsistent with the present Ruling, and that it is inappropriate to treat similar models in different industries differently. However, we do not accept that there is an inconsistency. The service provider does not carry on a business of trading in seismic data licences. That is, it does not buy, resell, distribute or sub-license its licences. It creates the data, which it owns, and from which copies of data segments are made and licensed to end customers. It does not release the master copy, or any copyright over the data. The continuity in the exclusive ownership of the data distinguishes the service provider's business from that in Sutton Motors, where goods changed possession.</p>	<p>Paragraph 7 of 93/12 makes no reference to the developer needing to buy, re-sell, distribute or sub-licence its licences in order for the licences to be treated as trading stock. The ruling paragraph clearly states that if software is developed for licence and the developer carries on a business of trading in such licences, then the licences are trading stock. Refer to section 7 of this submission.</p>
<p>Paragraph 87</p> <p>We do not consider that the timing of the revenue generated by licensing the data is conclusive. There is no general principle in taxation law of matching the timing of assessability of income with the timing of deductions for expenditure incurred in producing it. The character of an item of expenditure should not be confused with the character of the receipt associated with that expenditure. The character of one does not dictate the character of the other</p>	<p>The IAGC has not at any stage proposed an argument for revenue and expenditure matching. This has not been the IAGC position, nor should it be interpreted as such. Rather the IAGC's position is that the empirical evidence (refer to Section 4) supports the view that the advantage sought by the expenditure is one of short term revenue gains and that the multi-client library does not have any enduring benefit notwithstanding the term of the licence.</p>
<p>Paragraphs 66 to 78</p> <p>Appendix 3 – Alternative views</p> <ul style="list-style-type: none"> Capital / revenue cases cited in favour of revenue argument Distinguishing features 	<p>The discussions regarding the alternative views and distinguishing features are narrowly focused and selective and do not focus on the entirety of the multi-client business model. Refer to section 6 of this submission.</p>



22nd September 2017

Mr Kenneth Wee
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Australian Taxation Office

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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 2017/1: 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.
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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.
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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 years²). 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.

³ See the ATO's 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 loan 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."*

*"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 / 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.
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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 Memorandum⁶ 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.

* * * * *

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 any further questions.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Bruce Williams', is written over the typed name.

Bruce Williams

IAGC Austral Committee

Mr Kenneth Wee
Assistant Commissioner
Tax Counsel Network
Australian Taxation Office

By email: kenneth.wee@ato.gov.au
stephen.phillips@ato.gov.au

cc Andrew Mills - Andrew.Mills@ato.gov.au

**Multi-client seismic data
International Association of Geophysical Contractors
Summary of meeting on Tuesday 21 November 2017**

Dear Kenneth

Thank you for meeting with us on Tuesday 21 November 2017 to discuss the International Association of Geophysical Contractors' (IAGC) submission regarding 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?* (**proposed draft Tax Determination**).

The IAGC would like to acknowledge the level of consultation during this process. While there are differences in views as to the application of the tax law to the Multi-Client business, it is the view of the IAGC, that the ATO has shown a willingness to engage in open discussions and we look forward to the engagement process continuing.

As agreed with you, this letter outlines the key matters discussed during our meeting and sets out the IAGC's position with respect to each of these matters. We request that this letter be treated as a supplemental submission to the proposed draft Tax Determination and that these matters be considered in further detail by the Australian Taxation Office (ATO) prior to the issue of any draft Tax Determination, in whatever form and extent of distribution.

In particular, the key matters discussed during the meeting and the IAGC's comment on these matters are outlined below:

1. Revenue versus capital tax treatment

From our discussions with you, we understand that the ATO's view remains unchanged, that is that costs incurred to obtain multi-client data are capital in nature .

As previously noted in our submission, the IAGC believes that this binary view does not take into account the diversity of the multi-client business model in the industry nor does it recognise that in many circumstances parties will look to exploit the multi-client data in the very short term such that the costs should be treated as revenue in nature for tax purposes.

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The IAGC submits that each industry participant should be able to self-assess their own tax treatment for costs as revenue or capital in nature, based on their specific set of facts and circumstances. Accordingly the IAGC requests that the ATO again consider whether the draft Tax Determination in its current form (and blanket application to the industry) is an appropriate instrument to be issued given the range of factual circumstances and the breadth of relevant case law.

The IAGC further notes that as discussed with you, the treatment of seismic data costs is inconsistent with the treatment afforded by the ATO for an extended period (ie since 1993) to computer software that is licenced for simple use or sale. As previously noted in the IAGC submission, the use of multi-client data is similar to that of computer software and as noted in TR 93/12 and the Commentary on the OECD Model Tax Convention on Income and on Capital (2014) there will be circumstances where the tax characterisation of the transaction is one of a services payment or sale (i.e. general income received by the licensor through the use of the software or intellectual property) rather than a licence of an intellectual property asset.¹

Therefore the IAGC submits that the ATO should accept that expenditure incurred in obtaining the data is able to be deductible under section 8-1 as being inherently revenue in nature.

2. Exploration definition and policy considerations

Subject to the comments above, on an assumption the relevant expenditure is capital in nature, the IAGC submits the expenditure represents eligible exploration expenditure and be immediately deductible under section 40-80.

While we understand that the ATO has some reservations regarding the lack of nexus between the exploration and exploitation of the resource by the taxpayer incurring the expenditure, we submit that there is nothing in the legislation in section 40-80 or the definition of *exploration or prospecting* in section 40-730 that requires the entity conducting that exploration to exploit the resource or to hold a licence that enables it to exploit the resource in its own right.

Multi-client companies conduct exploration, typically geophysical surveys but may also include piston coring and geochemical studies, as an essential part of their business activities. These exploration activities are conducted on their own account, at their sole commercial risk, and therefore these companies should be entitled to equal treatment in claiming deductibility for that Exploration expenditure, as afforded to other participants within the same industry.

The IAGC considers that this matter requires detailed consideration by the ATO and an acknowledgement by the ATO that any historical policy intentions would not necessarily be applicable given the multi-client model is relatively recent. In this respect, the IAGC submits that the ATO should have regard to the resources industry use of the term "Exploration", including for example the specific inclusions within the definition of "Explore" under s19(1) of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* as it applies to Special Prospecting Authorities held by the multi-client companies. We also suggest the ATO consult with the Resources team at the Department of Industry, Innovation and Science as to policy considerations regarding the meaning of exploration.

¹ Refer to the Commentary on the OECD Model Tax Convention on Income and on Capital (2014), Commentary on Article 12, paragraphs 12-15.
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3. Clarity for balancing adjustments

We welcome the ATO's acknowledgement of the industry's concerns regarding the timing and identification of balancing adjustments. We understand that the ATO will clarify the conditions under which a balancing adjustment will occur for the seismic data by way of further examples and detail in the proposed draft Tax Determination.

As acknowledged by you in our meeting, the data should not need to be deleted or relinquished in order for a balancing adjustment event to occur. Rather a company should be able to demonstrate that it has ceased to use the data or a segment thereof for the purposes of meeting the requirements in section 40-295(1)(b) once no further revenue for the data is forecast.

This will require ATO to also define the unit of property of the data in a way which allows the industry to determine a balancing adjustment for segments of the data (for example, by way of graticular block or specific survey area).

The IAGC would like to further consult on the ATO views on this matter to develop principles which are consistent with industry practice in assessing the "writing off" of libraries.

4. Inconsistencies with software ruling TR 93/12

As discussed in our meeting and referred to above, the ATO is aware that the position taken in *Taxation Ruling TR 93/12: Income tax: computer software* which deems software developed for simple license or sale to be trading stock sets a precedent for the tax treatment of licensing intangible assets.

Participants in the Multi-Client industry in Australia are generally subject to the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* and associated regulations (we note depending on the location of the survey State legislation may apply). In broad terms, multi-client seismic data is required to be provided to the Titles Administrator in a prescribed format in a prescribed timeframe. The Titles Administrator can only then publically disclose the data in accordance with the Regulations to the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (which is ordinarily 15 years from the completion of the data acquisition). This legislative framework effectively provides the Multi-Client service provider with a period of exclusive distribution for that 15 year period.

Given the broad similarities of the multi-client business model with that of software distributors, the IAGC therefore submits that the ATO should:

- (a) Further consider whether the trading stock classification is appropriate in relation to multi-client data and provide a comprehensive analysis of the application of the trading stock provisions to multi-client data;
- (b) Consider accepting that TR 93/12 sets a precedent and that pursuant to the ATO's policy as set out in PS LA 2011/27, the ATO has therefore facilitated or contributed to the development of taxpayer's views or an industry practice which requires the ATO to issue the proposed draft Tax Determination on a prospective basis only.

* * * * *

As you are aware, representatives from the IAGC and EY will be meeting with Andrew Mills, Second Commissioner on 11 December 2017 and yourself to discuss the policy matters of concern as a result of the proposed draft Tax Determination.

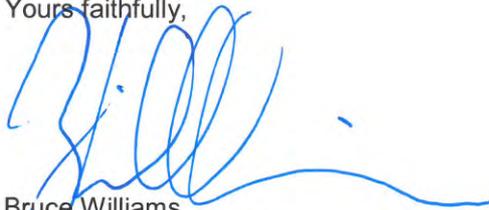
As also indicated in our meeting, the IAGC has had a subsequent discussion with the Department of Industry, Innovation and Science to discuss the impact of tax on the Multi-Client activities in Australia. Our discussion was with Bruce Wilson and his team.

The IAGC would appreciate if the ATO is able to provide the IAGC with any updated version of the proposed draft Tax Determination ahead of this meeting to the extent that it is available and able to be shared.

We thank you for the time you have taken to consult with the industry on the proposed draft Tax Determination and look forward to working with you and your team further.

Please do not hesitate to contact me (bruce.williams@tgs.com or +61 417 968 590) or Chad Dixon of EY (chad.dixon@au.ey.com or +61 8 9429 2216) if you have any further questions.

Yours faithfully,



Bruce Williams
IAGC Austral Committee

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**Submission to draft Tax Ruling TR 2017/D11
International Association of Geophysical Contractors
Appendix D - Correspondence with Andrew Mills dated 6 November 2017**

Mr Andrew Mills
Second Commissioner
Law Design and Practice
Australian Taxation Office
PO Box 900
Civic Square ACT 2608

6 November 2017

By email: alf.capito@au.ey.com

Copy: kenneth.wee@ato.gov.au

**Multi-client seismic data industry
Proposed draft Taxation Determination TD 2017/D[3840]
Policy and law interpretation matters**

Dear Andrew,

We write to you on behalf of our client, the International Association of Geophysical Contractors (**IAGC**) regarding 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?*

Summary of matters of concern

While the background and details of the matters concerning this letter have been explained in further detail below, in summary:

- The Australian Taxation Office (**ATO**) are currently in the process of drafting a Taxation Determination dealing with the taxation treatment of multi-client seismic data costs. The IAGC has and continues to engage with the ATO and your colleague Kenneth Wee on this matter.
- The IAGC is the global trade association representing the geophysical industry for over 45 years. The IAGC focuses on issues that affect the core businesses of the geophysical industry, including data acquisition, data processing and data ownership.
- Undertaking multi-client seismic activities represents a key business activity for seismic companies in this industry and Australia is a key market for these activities.
- The multi-client (non-exclusive) business model has emerged in Australia in recent years as a means to maximise the discovery and ultimately the exploitation of hydrocarbons by providing multiple parties, including governments and E&P Companies with an ability to access data. The multi-client model is an alternative and/or complementary business model to the traditional service model to a single customer, and facilitates a lower cost for each user of the data by spreading the cost over multiple parties.
- The taxation outcomes in Australia in respect of these multi-client activities has a key bearing on the sustainability and future of this business in Australia.

- The current process of engagement has and continues to provide the IAGC and its members with an ability to engage with the ATO on the tax technical matters relevant to taxation treatment of multi-client seismic activities.
- However, it is the view of the IAGC that the taxation treatment of multi-client seismic activities also gives rise to a number of policy and law design matters. It is the view of the IAGC that such matters should be considered in parallel with the interpretation of law within the proposed draft Tax Determination.

Current ATO views expressed in the proposed draft Taxation Determination

The proposed draft Taxation Determination currently seeks to treat expenditure incurred by the industry in obtaining seismic data for sale/licence under a multi-client business model (i.e. whereby the data is sold under a licence to multiple E&P companies) as on capital account rather than on revenue account.

Furthermore, the proposed draft Taxation Determination currently provides for the non-application of the exploration provisions in Division 40 of the *Income Tax Assessment Act 1997* (specifically sections 40-730 or section 40-80), such that costs in obtaining multi-client data are currently proposed to be treated as depreciable over a pre-determined 15 year life, with no ability to re-assess the effective life.

Background to consultation with ATO

The IAGC has played and continues to play an active role in consulting with the ATO on the proposed draft Taxation Determination prior to its release. This has included the preparation of a detailed technical submission dated 22 September 2017 (a copy is attached). The IAGC's submission considered in depth the substantive technical matters (primarily revenue vs capital distinction) of law upon which the IAGC disagrees with the ATO's views in the proposed draft Taxation Determination. We understand that the ATO is still considering the IAGC's submission (and other submissions received) and the IAGC will be further engaging with the ATO in respect of the IAGC's submission.

However, the IAGC considers there are also a number of policy and law design issues that require consideration prior to the release of any proposed draft Taxation Determination, and which we seek to bring to your attention. These policy and law design issues go beyond the technical matters currently being considered by the ATO (and which have been specifically noted as not within the scope of the current ATO team's remit). These matters were raised in the IAGC's submission and are outlined in further detail below.

Law interpretation policy matters – Significant divergence between the commercial and tax outcomes

The position taken in the current proposed draft Taxation Determination for a statutory 15 year write off period for expenditure incurred in generating seismic data represents a significant divergence between the commercial and tax outcomes.

That is, the interpretation the ATO is seeking in the proposed draft Taxation Determination will result in a significant mis-match between the revenue timing, which occurs primarily prior to finalising the multi-client seismic activities (i.e. via pre-funding estimated to be 70% of total anticipated income) and in the immediate period after undertaking the activities (i.e. years 1 to 5) as compared to a statutory 15 year tax depreciation period.

The timing mismatch is also highlighted by the financial statement treatment of multi-client seismic costs whereby costs reflected in the profit and loss are more aligned with the timing of revenue derivation.

Based on the commercial realities of revenue generation from the relevant expenditure in this industry, it is the view of the IAGC that a revenue deduction under section 8-1 should be provided as a matter of fairness and equity. This is particularly where the activities are undertaken with the intent of immediate and near term monetisation of the multi-client data.

Furthermore, it is noted that while historically the seismic industry in Australia was characterised by the provision of a service to resource companies, the emergence and importance of the multi-client business model has re-characterised the nature and risk of activities now undertaken by the industry in Australia. Therefore, while traditionally it was the view that seismic services were not within the exploration provisions of the tax legislation, the nature of the multi-client business is now sufficiently similar to that of exploration companies and accordingly should be afforded a similar treatment.

The scope and intent of the amendments to section 40-80 (applicable from 14 May 2013) did not envisage that they would result in the imposition of a statutory 15 year write off period on this industry. This measure was specifically designed to prevent the immediate deductibility of significant acquisition premiums being paid by resources companies for exploration assets. Specifically the amendments were made for the following purposes, as outlined in the Explanatory Memorandum and Second Reading Speech to the *Tax and Superannuation Laws Amendment (2014 Measures No.3) Bill 2014*.

“This Bill is an integrity measure which is designed to ensure that the immediate deduction for rights and information fulfils its original purpose of encouraging genuine exploration. There was evidence that the immediate deduction was being used to obtain a deduction for the value of resources already discovered rather than for the right to search for yet to be discovered resources. This is outside the policy intent of supporting genuine exploration.”

Furthermore, we note that amendments intended at all times to keep as available an immediate deduction for expenditure incurred in genuine exploration activities that created new mining information as noted in the Explanatory Memorandum and Second Reading Speech as follows:

“The immediate deduction will remain for the cost of rights acquired from a government issuing authority, the cost of geological, geophysical or similar information acquired from government authorities and the cost of data packages acquired from private providers.”

Therefore, the approach currently being proposed in the Taxation Determination is inconsistent with the policy intent and design of these law amendments. In light of the above, we request that the ATO have due regard to the fairness and equity sought by the industry in matching the revenue generated against expenditure incurred, prior to issuing any draft Taxation Determination.

Broader policy matters – Potential implications on Australian Exploration

The impact of the proposed draft Tax Determination will be to discourage Australian exploration through the multi-client business model by increasing the cost of these activities to Australian E&P companies. This impact should be considered further given the current environment whereby the IAGC is of the view that exploration for the sourcing of new energy projects should be encouraged.

* * * * *

We would welcome the opportunity to discuss these matters with you in further detail by way of a conference call or meeting. Could you please advise whether you would be able to meet or speak to us regarding the policy concerns raised so that these matters can be addressed prior to the public release of a draft Taxation Determination.

Please do not hesitate to contact me on (02) 8295 6473 or Chad Dixon on (08) 9429 2216 should you wish to discuss the content of this letter in further detail.

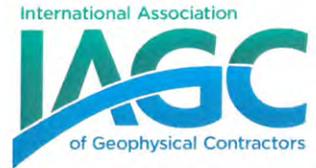
We look forward to your response.

Yours sincerely,



Alf Capito
Partner - Taxation

**Submission to draft Tax Ruling TR 2017/D11
International Association of Geophysical Contractors
Appendix E - Submission to Department of Resources dated
1 December 2017**



ENERGY STARTS HERE

1 December 2017

Mr Bruce Wilson
Resources Team
Department of Industry, Innovation and Science
GPO Box 2013
Canberra ACT 2601

Copy: Joshua Reakes
Lisa Schofield
Emma Reid
Rita Fatale

**International Association of Geophysical Contractors
Taxation of multi-client seismic data industry**

Dear Bruce,

We would like to thank you and your team for your attendance at the teleconference on Thursday 23 November 2017 with members of the International Association of Geophysical Contractors (**IAGC**) and EY to discuss the multi-client seismic data industry.

The IAGC appreciates the Department's support of the industry's exploration work in Australia and the attention given by the Department to the Australian Taxation Office's (**ATO's**) proposed taxation treatment of costs incurred in obtaining multi-client seismic data, as currently set out in the proposed draft Taxation Determination TD 2017/D[3840] (**the draft TD**).

As agreed during the teleconference, the IAGC has initiated a survey of members to provide the Department with further information regarding the level of investment in Australian exploration to demonstrate the significant involvement that the industry has in Australian exploration and the value of investment that will be at risk in the event that the ATO's views as outlined in the proposed draft TD are adopted.

As noted in our discussions, the proposed tax treatment, which requires the cost of obtaining multi-client data to be depreciated over 15 years, will put Australian geophysical service providers at a significant cash flow disadvantage. This will in turn jeopardise future multi-client exploration activity in Australia and impact employment. The uncertainty surrounding the draft TD is already having a negative impact on the investment decisions of multi-client companies – as the commercial return from some projects otherwise readily undertaken would be fully consumed by the higher tax cost imposed under the proposed tax change. To illustrate this point, I have attached an example quantifying the post-tax loss that would be incurred in carrying out a project that generates 30% nominal profit – please refer to the attached Appendix.

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In our discussions, you indicated that you would reach out to the ATO Energy and Resources team at the ATO to further discuss the potential application of the proposed draft TD and its impact on multi-client exploration in Australia. Given the potential impact that the proposed taxation treatment will have on the multi-client industry, we welcome any assistance the Department is able to provide in relation to policy interpretation matters regarding "exploration" and the role of the multi-client seismic companies in undertaking exploration.

Multi-client companies carry out exploration, typically geophysical surveys (but may also include piston coring and geochemical studies), as an essential part of their business activities. These exploration activities are conducted on their own account, at their sole commercial risk, and therefore should be afforded the same tax treatment as other participants within the same industry. While discussions with the ATO are continuing, we are concerned that if ultimately multi-client survey activities are not treated as immediately deductible exploration, such an outcome would be unreasonable. We believe that the existing tax law allows for the appropriate classification of multi-client surveys as immediately deductible exploration for tax purposes.

For your information we have a meeting with Andrew Mills, ATO Second Commissioner and Kenneth Wee (the principal ATO author of the draft TD) on 11 December 2017 to further discuss the policy matters associated with the proposed draft TD. The meeting will be attended by IAGC representatives and EY.

We will keep you informed of any progress with the ATO on this matter. We hope that an agreement can ultimately be reached with the ATO in relation to these policy matters having regard to the existing tax legislation. However, if such an outcome is not achievable, we would like to remain engaged with you regarding prospective tax policy settings given the Australian government's focus on promoting exploration.

We welcome the opportunity to discuss any further comments or questions you may have in relation to the proposed tax treatment or the multi-client industry generally. Should you have any additional questions or comments, please do not hesitate to contact me (bruce.williams@tgs.com on +61 417 968 590) or Chad Dixon of EY (chad.dixon@au.ey.com or +61 8 9429 2216).

Yours faithfully,



Bruce Williams
IAGC Austral Committee

Typical Multi-Client Survey

Future Values...

Percentage of Revenues

Revenues

Project Costs

Net Income

Taxable Income

Tax Deductions (15yrs Dim.; W/off Yr15)

Net Taxable Income

Tax Payable @ 30%

Net Present Values...

NPV of Revenues

NPV of Project Costs

NPV of Profit Generated

NPV of Tax Payable

Net Cashflow

	WIP	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10	Yr 11	Yr 12	Yr 13	Yr 14	Yr 15	Total
Percentage of Revenues	54%	23%	15%	4%	4%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%
Revenues	\$70.0	\$30.0	\$20.0	\$5.0	\$5.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$ 130.0
Project Costs	\$100.0															\$ 100.0
Net Income	-\$30.0	\$30.0	\$20.0	\$5.0	\$5.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$ 30.0
Taxable Income	\$70.0	\$30.0	\$20.0	\$5.0	\$5.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$ 130.0
Tax Deductions (15yrs Dim.; W/off Yr15)	\$13.3	\$11.6	\$10.0	\$8.7	\$7.5	\$6.5	\$5.7	\$4.9	\$4.2	\$3.7	\$3.2	\$2.8	\$2.4	\$2.1	\$13.5	\$ 100.0
Net Taxable Income	\$56.7	\$18.4	\$10.0	-\$3.7	-\$2.5	-\$6.5	-\$5.7	-\$4.9	-\$4.2	-\$3.7	-\$3.2	-\$2.8	-\$2.4	-\$2.1	-\$13.5	\$ 30.0
Tax Payable @ 30%	-\$17.0	-\$5.5	-\$3.0	\$1.1	\$0.8	\$2.0	\$1.7	\$1.5	\$1.3	\$1.1	\$1.0	\$0.8	\$0.7	\$0.6	\$4.0	-\$ 9.0
NPV of Revenues	\$70.0	\$26.3	\$15.3	\$3.3	\$2.9	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$ 117.8
NPV of Project Costs	\$100.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$ 100.0
NPV of Profit Generated																\$ 17.8
NPV of Tax Payable	-\$17.0	-\$4.84	-\$2.29	\$0.74	\$0.44	\$1.0	\$0.8	\$0.6	\$0.4	\$0.3	\$0.3	\$0.2	\$0.1	\$0.1	\$0.6	-\$ 18.5
Net Cashflow	-\$47.0	\$24.5	\$17.0	\$6.1	\$5.8	\$2.0	\$1.7	\$1.5	\$1.3	\$1.1	\$1.0	\$0.8	\$0.7	\$0.6	\$4.0	\$ 21.0

Key Assumptions:

Project Gross profit margin

30%

Revenue Period

Typical Revenue Pattern

NPV discounting at pre-tax WACC

12.5%

Tax Losses immediately recoverable against alternate project future revenues (not always true)

Effective Tax Rate (NPV basis)

NPV - Project After Tax Profit

104%

-\$ 0.7

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Appendix

International Association
of Geophysical Contractors

ENERGY STARTS HERE



Ms Lisa Schofield
Resources Team
Department of Industry, Innovation and Science
GPO Box 2013
Canberra ACT 2601

30 January 2018

Copy to:

Australian Taxation Office: Andrew Mills, Louise Clarke, Kenneth Wee

EY: Chad Dixon, Anna Satinover

**International Association of Geophysical Contractors (IAGC)
Taxation of multi-client seismic data industry**

[Redacted content]

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