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Exploration Development Incentive - exposure draft legislation

The Australian minerals industry welcomes the release of the draft legislation to implement the Government's Exploration Development Incentive (EDI).

This submission represents the views of the minerals industry for and on behalf of:

- The Minerals Council of Australia (MCA);
- The Chamber of Minerals and Energy of Western Australia;
- Queensland Resources Council;
- The New South Wales Minerals Council;
- South Australian Chamber of Mines and Energy;
- Tasmanian Minerals and Energy Council; and
- The Victorian and Northern Territory Branches of the Minerals Council of Australia.

The industry has advocated for a number of years the need to address the tax asymmetry whereby junior explorers with no taxable income are not able to benefit from the immediate deduction for exploration. The industry supports the introduction of the EDI to overcome this tax asymmetry and encourage exploration to help ensure a future pipeline of resource projects in Australia.

As noted in the joint industry submission in April 2014 on the *Exploration Development Incentive: Policy Design* discussion paper, the industry supports the EDI on the basis that it measures up well against the industry's key principles for an effective tax mechanism:

- Targeted at junior companies;
- Available directly to investors/shareholders;
- Minimises administrative costs for companies, regulators and investors;

- Avoids distortions between shareholders or companies; and
- Utilises existing definitions and tax law concepts.

The EDI intentionally limits the measure to greenfields exploration undertaken by resident junior explorers and is available directly to shareholders. However, whilst the drafting employs some existing tax definitions, it introduces an additional definition of exploration, viz, "greenfields exploration". As the submission discusses in the following paragraphs, the introduction of a new concept of "greenfields exploration" in the tax law which excludes expenditure on economic feasibility is not necessary to target greenfields exploration expenditure and does not accord with the ordinary and accepted meaning of exploration.

The industry notes that the draft legislation incorporates a number of suggestions the industry has made at the policy design stage and offers the following comments.

1. Eligible explorers and expenditure

(a) "Greenfields" minerals explorers

The legislation includes a "no mining activities" test which will target the EDI at junior minerals explorers.

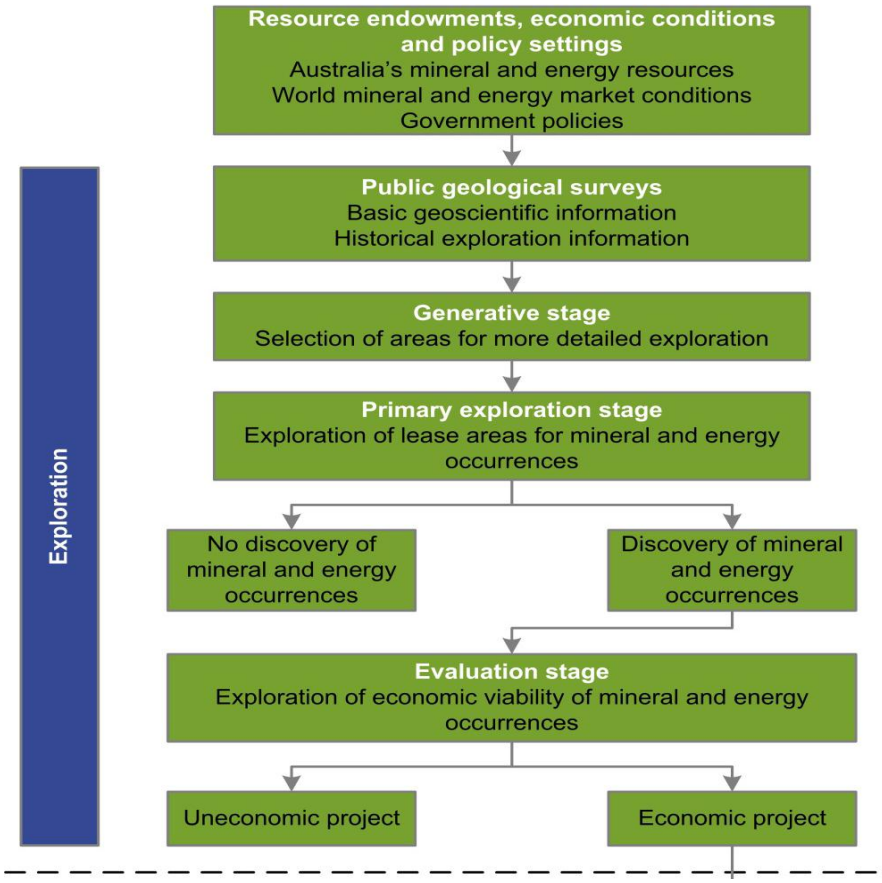
The EDI appropriately relies on the existing definition of "mining operations" in section 40-730 of the *Income Tax Assessment Act 1997* (ITAA 1997) to limit access to the credit to juniors undertaking exploration only.

It is also appropriate that a "greenfields minerals explorer" is a disclosing entity and a constitutional corporation to bolster the integrity to the tax credits. It will ensure that only explorers operating under greater regulatory scrutiny and corporate governance arrangements are eligible for exploration tax credits.

(b) Greenfields minerals expenditure

The legislation creates a new concept of "greenfields minerals expenditure" which excludes expenses to assess the economic viability of an identified resource which lead to the development of a mine.

As the industry submitted during consultation on the measure, assessing economic viability is integral phase of the exploration process since it is the gateway to the advancement of resource projects to production. To that end, the Productivity Commission's 2013 report Mineral and Energy Resource Exploration included the following diagram which outlines the exploration phase of a mining project including economic evaluation:



Mineral and Energy Resource Exploration. Productivity Commission Inquiry Report No. 65, 27 September 2013.

Whilst the industry acknowledges that the EDI measure has been intentionally limited on policy grounds to activities attendant to locating resources and revenue constraints, the new definition of "greenfields exploration" is superfluous in so far as the new concept ignores the body of case law relating to the definition of exploration activities that might otherwise be relied upon and ignores the existing definition of exploration and prospecting activities in the ITAA 1997 (recognising that section 40-730(4)(c)) would be exorcised from the EDI definition of exploration). Furthermore, the introduction of the "greenfields exploration" concept would result in different concepts of "exploration" for the EDI regime, for the Petroleum Resource Rent Tax (PRRT) and for income tax.

To that end, we submit that adopting the existing income tax definition of exploration or prospecting (adjusted to exclude 40-730(4)(c) should not extend access to the EDI beyond what we understand "greenfield" exploration is intended to refer to for the purposes of the EDI measure. We would add that we do not see the need for references to the JORC code to define the parameters of what is exploration (or "greenfields exploration for the purposes of the legislation), and that the concept ought to be removed from the draft legislation.

Should the Government continue with the narrow definition of exploration for the purpose of the EDI measure, (thereby excluding feasibility study expenditure captured by section 40-730(4)(c)), in the interests of clarifying the policy behind the limitation a specific comment should be included in the Explanatory Material (EM) to distinguish the use of the new concept of exploration expenditure from the ordinary meaning of exploration in 40-730 and 40-80 and from the meaning in the PRRT Act. The EM should explicitly state that the concept of exploration for the purposes of the EDI regime has been intentionally limited to

include exploration activities comprising the search for minerals in accordance with the policy and costing of the EDI.

2. **Issuing exploration credits**

The legislation provides flexibility to companies in deciding whether all shareholders or only "new shares" issued after 1 July 2014 of eligible explorer companies can receive tax credits. Importantly, credits are available at the shareholder level to maximise the effectiveness of the EDI by allowing explorers to leverage additional investment in their companies and retain existing shareholdings.

3. **Other drafting comments**

The following minor comments are made on wording in the EM on income tax and exploration expenditure:

- Paragraph 1.9 – the statement that exploration is “generally” capital in nature and is likely to be on capital account is not the case. This should be removed.
- Paragraph 1.12 - the suggestion that most exploration expenditure is likely to be deductible under the immediate deduction provisions is also not accurate since an entity that is in the business of exploring may be entitled to deduct much of its exploration expenditure on revenue account under section 8-1.
- Paragraph 1.66 – also makes the comment that all expenditure is deductible under 40-730.

The industry looks forward to the introduction of legislation to provide certainty to explorers and investors on the status of exploration tax credits under the EDI.

Should you require any further explanation of the issues raised, please contact me (James.Sorahan@minerals.org.au or 03 8614 1816) in the first instance.

Yours Sincerely

James Sorahan

Director – Taxation