



Australian Government

Exploration Development Incentive: Policy Design

Treasury and Department of Industry Discussion Paper
March 2014

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CONSULTATION PROCESS

Request for feedback and comments

The Government seeks your feedback and comments on the design of the Exploration Development Incentive. The information obtained through this process will inform the Government's approach to implementation and assist in meeting the requirements of the Office of Best Practice Regulation.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

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Closing date for submissions: 4 April 2014

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1. INTRODUCTION

1. This paper is intended as a basis for consultation on the policy of the Exploration Development Incentive.
2. The Exploration Development Incentive was announced on 3 September 2013 by the then Shadow Minister for Energy and Resources, and was outlined in the *Coalition's Policy for Resources and Energy September 2013* (as set out below).

An Exploration Development Incentive

The Coalition will introduce an Exploration Development Incentive that will allow investors to deduct the expense of mining exploration against their taxable income.

Under our scheme, the Australian Taxation Office will determine a proportion of expenses that can be claimed as tax credits by investors. Our scheme will target small exploration companies by limiting eligibility to companies with no taxable income.

Our scheme will start for investments made from 1 July 2014. The scheme will be capped at \$100 million over the forward estimates.

The Coalition will get the exploration industry back on its feet following the devastating loss of confidence for investment in mineral exploration in Australia caused by the Rudd-Gillard Government's introduction and gross mishandling of the MRRT.

The future prosperity of the mining sector and the Australian economy is dependent on our ability to make new mineral discoveries.

The Exploration Development Incentive will provide incentives for minerals exploration activity, with a focus on the small and mid-tier exploration sector.

Under the proposed program, a tax credit will be provided to Australian resident shareholders for eligible 'green fields' exploration expenditure incurred in Australia. A 'no taxable income' test will ensure that the program is only available to junior minerals explorers.

Final implementation details will be determined in consultation with peak industry representative bodies, and will be reviewed every twelve months. Subject to these review outcomes, the program may be extended for a further period.

3. This paper outlines and seeks feedback on possible implementation arrangements for the following elements of the Exploration Development Incentive:
 - how to target junior mineral explorers;
 - which investors will be able to receive exploration credits;
 - how will 'eligible expenditure' and 'greenfields' be defined;

- how will the modulation process work; and
- how will the exploration credit system work?

2. HOW TO TARGET JUNIOR MINERALS EXPLORERS?

4. The purpose of the scheme is to provide an incentive for investment in junior mineral exploration companies, that is, companies that engage in exploration for new mineral discoveries that meet the 'no taxable income' test.
5. To effectively target junior mineral exploration companies, a 'no taxable income' test could operate so that exploration credits can only be distributed by a company that has a tax loss for the year in which the relevant expenditure is incurred. In addition to this test, the scheme could exclude companies that derive assessable income from mining activities in the income year in which exploration expenditure is incurred. Alternatively, any assessable income from mining activities could reduce the exploration expenditure eligible for the scheme. Together, the 'no taxable income' test and 'no mining activities' test would target the scheme at small companies engaged in minerals exploration activities.
6. To ensure the integrity of the scheme, eligibility to participate in the scheme could be confined to Australian resident companies that are widely held as defined in section 995-1 of the *Income Tax Assessment Act 1997* (ITAA). This confines the scheme to listed companies or companies with over 50 members and dispersed ownership. Rules may be needed in relation to subsidiaries and joint ventures.
7. A related entity test may also be required to ensure that the eligibility criteria in respect of an entity's size cannot be circumvented by a large entity accessing the scheme through a relatively smaller interposed subsidiary.

2. Questions

2.1. Will a 'no taxable income test' and a 'no mining activities test' effectively target the measure to junior minerals explorers who are not able to utilise their tax losses?

~~2.1.~~ A: Yes!

2.2. How should the 'no mining activities' test operate to ensure the incentive targets small mineral exploration companies?

~~2.2.~~ A: The activities should be limited to those conducted on Exploration Titles, not production titles such as Mining Leases.

2.3. Could the approach to restrict eligibility to Australian resident companies that are widely held prevent some junior minerals explorers from accessing the incentive?

A: The aim of this incentive is to stimulate greenfields exploration and the industry that sustains this. You are not targeting the individual prospector and the sponsor that grubstakes him. You are targeting the junior exploration company dependent for

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their funds on investors who are prepared/ able to take a risk, and the institutions that connect these investors with opportunities. I wish to point out that most of these investments are driven by the hope of quick and spectacular capital gains by successful discoveries than they are by hopes of dividends from the profitable mining that might eventually follow from a successful discovery. That is the true nature of the investor in the sector, and what distinguishes the Australian (and Canadian) stock exchanges from most that operate globally. This is the secret to the success of the modern mining industry and why Australia and Canada play such a dominant role in it. I hope that the scheme can be designed with that in mind.

~~2.3.~~

3. WHICH INVESTORS WILL BE ABLE TO RECEIVE EXPLORATION CREDITS?

~~8.~~ It is proposed that companies will be able to distribute exploration credits to their members that have equity interests when exploration credits are distributed.

~~8.~~ Is it possible to consider distributing to subscribers for new capital that retain the shares at the time of distribution of the credits?

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9. This is consistent with the imputation system and ensures only shareholders that could receive an economic benefit from company tax losses (were the company to retain its losses) will receive the benefit of an exploration credit.

3.1 ALL SHARES OR NEW SHARES?

~~10.~~ Exploration credits could either be provided to all shareholders, or confined to the holders of 'new shares'.

~~10.~~ The intention of the incentive is to stimulate exploration expenditure. I am strongly of the view that the credits should apply to subscriptions for new shares only.

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~~11.~~ Providing the exploration credit to all shareholders would be the simplest option for companies to implement. Under this approach, companies will distribute exploration credits to all shareholders on their share register on the exploration credit distribution date. This approach seeks to minimise the red tape burden on companies.

~~11.~~ If the exploration credits are provided on newly issued shares that are still held at the time of distribution it should not be too complex to administer.

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12. Alternatively, confining exploration credits to new shares would target the incentive to additional investment in mineral exploration companies. Under this approach, exploration credits could only be made available to the holders of shares issued in the expenditure year (and perhaps the prior year, from the scheme's second year of operation). Confining exploration credits to new shares would increase the incentive for additional investment in exploration activity, but would also increase the red tape of the scheme.

3. Question

3.1. What are the pros and cons of companies distributing exploration credits to all shareholders compared to the alternative approach of requiring new share issues? Which is the preferred option?

A: In answer to the second question, I strongly believe that the scheme should be squarely directed at assisting the acquisition of new capital for grass roots exploration.

3.1- This will not be encouraged to anywhere near the same degree if it does not preferentially reward new subscribers of capital. This can be further qualified and restrained by having the exploration co prepare a succinct prospectus for the raising, and the raising should clearly set out the terms for which funds would be utilised, including their use for "exploration or prospecting"

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4. HOW WILL 'ELIGIBLE EXPENDITURE' AND 'GREENFIELDS' BE DEFINED?

13. The Exploration Development Incentive will apply to eligible 'greenfields' exploration expenditure incurred in Australia from 1 July 2014.
14. There are two aspects to determining what should constitute eligible 'greenfields' exploration expenditure.
 - What is eligible exploration expenditure? That is, what are the activities being undertaken in the course of exploring for a mineral resource?
 - What is meant by 'greenfields'? That is, the discovery of new resources.
15. Together, these aspects will ensure that the Exploration Development Incentive targets expenditure on exploration leading to new discoveries.

4.1 WHAT IS EXPLORATION EXPENDITURE?

16. Exploration expenditure is immediately deductible against assessable income for company income tax purposes under sections 40-80 and 40-730 of the ITAA. Therefore, the scope of activities that are considered as exploration expenditure is important.
17. Given that the losses targeted by the Exploration Development Incentive arise as a result of the relevant treatment under the ITAA, a practical approach could be to adopt a definition for eligible exploration expenditure based on the current definitions in the ITAA. A way of achieving this would be to define activities pertinent to exploration in accordance with the reference to exploration and prospecting at subparagraph 40-730(4)(a)(i) of the ITAA, which is part of Australian tax law and is familiar to industry. Subparagraph 40-730(4)(a)(i) states that 'exploration or prospecting includes':

geological mapping, geophysical surveys, systematic search for areas containing minerals (except petroleum) or quarry materials, and search by drilling or other means for such minerals or materials within those areas.

While that definition is sound, a major cost in modern exploration is the negotiation of access rights and the maintenance of these rights to allow discovery and definition of the discovery. Some provision for acquisition and maintenance of access rights should be included in the definition. For example, all exploration agreements on Aboriginal controlled land have compensation provisions that are usually related to exploration expenditure; costs of title rentals (not acquisition) continue to increase and are becoming in some jurisdictions a disincentive to greenfields exploration which requires large holdings.

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18. In this context, 'minerals' would take the meaning given to it by subsection 40-730(5) of the ITAA, but would exclude 'petroleum', as defined by subsection 40-730(6) of the ITAA. Exploration for geothermal energy resources, as defined by subsection 40-730(7A) of the ITAA would also be excluded from the Exploration Development Incentive.

19. So that the definition does not extend beyond greenfields exploration, the definition would not include the other aspects of the definition for 'exploration or prospecting' in subsection 40-730(4). Expenditure on activities normally associated with feasibility, including activities aimed at determining whether it is economically (including technically) feasible or commercially viable to proceed to development, or how best to develop a known mineralisation, would be excluded from the Exploration Development Incentive.

~~19.~~ I agree.

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4.2 WHAT IS MEANT BY GREENFIELDS?

20. Limiting the Exploration Development Incentive to exploration in 'greenfields' areas is designed to focus the incentive on the search for new discoveries, noting that much of this work is conducted by the small to mid-tier exploration sector.

21. There have been numerous previous attempts to explicitly define what constitutes greenfields exploration, or a greenfields area. While the majority of these rely on some form of spatial distinction between greenfields and brownfields, and some consider the temporal dimension, a key theme is consistently evident:

greenfields exploration is exploration of unexplored or incompletely explored areas directed at discovering new resources.

Suggest: "...not associated with existing processing facilities owned by the company"

22. Rather than using a spatial based definition to achieve the objective of targeting the Exploration Development Incentive at greenfields exploration, the scheme could adopt an approach that would further limit the type of exploration activity that would be eligible.

23. This is a simpler approach and similar to that used by Canada in relation to its tax incentives for mineral exploration.

24. Under this approach, eligible exploration expenditures would be those incurred on activities that are deployed for the purpose of determining the existence, location, extent or quality of a new mineral resource in Australia. In broad terms, the intent of this definition is to encourage 'grassroots' exploration activities, or the generative and early stage exploration for new mineral deposits.

25. An additional measure to restrict the Exploration Development Incentive from brownfields exploration could be to exclude from the definition of eligible exploration expenditure any expense related to:

- a mine that has come into production or to a potential or actual extension of a mine; or
- a mineralisation that has been classified as an Inferred Mineral Resource or higher under the Joint Ore Reserves Committee (JORC) Code.
 - ▲ I believe this should relate to an Indicated Resource or higher under JORC, since only an Indicated or Measured Resource can be converted to an Ore Reserve. Stand alone Inferred Resource is still high risk.

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4. Questions

4.1. Should the Exploration Development Incentive be available to companies exploring for quarry materials? Why/why not?

4.1. In my view, no, as the discovery of quarry materials alone is unlikely to lead to the major resource developments that this incentive is targeted at.

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4.2. Would the proposed approach of aligning the definition with subparagraph 40-730(4)(a)(i) of the ITAA potentially exclude activities that are, by nature, the search for new discoveries? If so, please provide examples.

4.2. I think the definition is good but should be extended to include the costs of permitting (not application for titles) and access once the exploration title is obtained. In recent times in all Australian jurisdictions these have become a significant disincentive to greenfields exploration. I would be happy to provide more details and examples if necessary.

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4.3. Conversely, would this definition capture exploration activities that are evaluating the economic viability of a known resource?

5. HOW WILL THE MODULATION PROCESS WORK?

26. The scheme is to be capped at \$100 million over the forward estimates period. The Coalition's *Final Update on Federal Coalition Election Commitments* of 5 September 2013 indicated that exploration credits will be capped at \$25 million for exploration expenditure incurred in 2014-15, \$35 million for exploration expenditure incurred in 2015-16 and \$40 million for

exploration expenditure incurred in 2016-17. In that update, the fiscal budget impact was as outlined in Table 1.

Table 1 — Fiscal Budget Impact of the Exploration Development Incentive

| 2013-14 \$m | 2014-15 \$m | 2015-16 \$m | 2016-17 \$m |
|----------------|----------------|----------------|----------------|
| - | -25 | -35 | -40 |

27. The cap for a particular year refers to the maximum exploration credits that can arise in respect of the exploration expenditure incurred in that particular year. For example, the cap for 2014-15 refers to the maximum exploration credits that can flow from exploration expenditure in 2014-15, regardless of when shareholders receive their tax offsets, which will be in a later income year. It is proposed that where total exploration credits are less than the cap for any given year, the leftover amounts are lost and will not be available in subsequent years. Carrying forward leftover amounts would be administratively difficult because the Government will not know the unspent amount until at least three years after the respective expenditure year.
28. Unlike grant based programs, tax expenditures are generally not capped. As such, this aspect of the scheme will require special rules and it is proposed that a modulation process be used to ensure that the cap is not breached.
29. An unavoidable consequence of a modulation process is that there will be a delay in the actual distribution of exploration credits. The only option to avoid this would be to provide exploration credits purely on an expectations basis, which is considered unlikely to be tenable from an integrity perspective because participants would have an incentive to overstate their expectations.
30. A modulation process could work on either an ex-post or ex-ante basis or a combination of the two. An 'ex-post' cap would rely on reported 'eligible losses' (see subsection 6.1 below) after the expenditure year while an 'ex-ante' approach would rely on both companies' expectations of their 'eligible losses' as well as their reported 'eligible losses' after the expenditure year. A company will be able to convert its losses into exploration credits at the company tax rate, but during modulation the ATO will determine the losses companies may convert (so that the cap is not exceeded).
31. The key trade-offs around a modulation process relate to:
 - investor certainty;
 - the regulatory burden of the scheme;
 - the start date of the scheme; and
 - utilisation of the cap.
32. The operation of each of the possible modulation processes is discussed in more detail below. Table 2 sets out some of the advantages and disadvantages of each approach.

Table 2 — Comparison of the possible approaches to modulation (continues over the page)

| Approach | Advantages | Disadvantages |
|---|---|--|
| - Ex-post modulation | <ul style="list-style-type: none"> - Minimises reporting requirements. - Maximises exploration credits paid out. - Can commence on 1 July 2014 | <ul style="list-style-type: none"> - Limited certainty for investors. |
| - Ex-ante modulation | <ul style="list-style-type: none"> - Higher level of investor certainty with regard to the modulation factor. | <ul style="list-style-type: none"> - Greater reporting requirements. - Unlikely to be able to commence on 1 July 2014. - Could result in lower utilisation of the cap. - Potential for companies to overstate expected losses. |
| - Combination of ex-post and ex-ante modulation | <ul style="list-style-type: none"> - Higher level of investor certainty with regard to the modulation factor. - Maximises exploration credits paid out. | <ul style="list-style-type: none"> - Greater reporting requirements. - Unlikely to be able to commence on 1 July 2014. - Potential for companies to overstate expected losses. |

5.1 EX-POST MODULATION

33. In broad terms an ex-post modulation would require companies to notify the Australian Taxation Office (ATO) of their 'eligible loss' and eligibility for the scheme in respect of the previous financial year (the expenditure year), and lodge their tax return by a cut-off date, for instance 1 March following the expenditure year.
34. The ATO would then calculate the total 'eligible losses' reported for the expenditure year. If the total exploration credits that would result from the 'eligible losses' exceed the cap set by the Government for the expenditure year, the ATO would calculate an appropriate modulation factor (so that the cap is not exceeded) and advise eligible companies of the proportion of their 'eligible losses' they will be entitled to provide to shareholders as exploration credits.
35. Companies will not be able to flow through the benefit of more than their 'available loss', that is, the modulation factor multiplied by their expenditure year 'eligible loss'.
36. This approach would minimise the regulatory burden of the scheme, ensure the cap is fully utilised and enable the scheme to apply to relevant expenditure incurred from 1 July 2014.
37. However, investors would not be able to determine the quantum of the exploration credit if they were to invest in the expenditure year unless they could reliably estimate both the company's likely 'eligible loss' and total 'eligible losses' for all eligible companies in that year.

5. Question

5.1. Under ex-post modulation, will exploration companies be able to provide investors

with an indication of the likely value of the exploration credit based on existing information sources about both their own and the sector's exploration intentions?

~~5.1.~~ A: Clearly, the answer to this is no.

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5.2 EX-ANTE MODULATION

38. An ex-ante modulation would involve companies notifying the ATO of the estimated 'eligible loss' they expect to incur in the forthcoming year (the expenditure year). Where the total expected 'eligible losses' would cause the cap to be exceeded, the ATO would calculate this and advise companies of the modulation factor before the beginning of the expenditure year.
39. Following the expenditure year, companies that have lodged their tax returns and notified the ATO of their expenditure year 'eligible loss' and eligibility would be able to provide shareholders with the economic benefit of their losses up to their 'available loss' (see Glossary).
40. Where a company's 'eligible loss' exceeds or meets expectations, their 'available loss' would be their expected 'eligible loss' multiplied by the modulation factor. Where the company's 'eligible loss' falls short of expectations, their 'available loss' would be their 'eligible loss' multiplied by the modulation factor.
41. When compared to the ex-post approach, the ex-ante approach provides a moderately higher level of certainty for investors as they could estimate the company's 'eligible loss' to get an idea of the exploration credit they might receive. However, as the amount of credits that can be passed on by a company is dependent on the actual 'eligible loss', there is still a level of investor uncertainty given the potential for that loss to fall short of expectations.
42. The ex-ante approach would also increase the regulatory burden of the scheme, is likely to result in the cap not being fully utilised and is unlikely to be able to commence on 1 July 2014 (because legislation would need to be enacted prior to the modulation process).

5. Question

~~5.2.~~ Is the greater certainty under an ex-ante modulation approach desirable, noting the trade-offs (greater regulatory burden, not fully utilising the cap and potential delay in starting the scheme)?

~~5.2.~~ A: No. Please refer to my answer at 2.3. Investors that value certainty should not invest in greenfields exploration!

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5.3 EX-POST AND EX-ANTE MODULATION

43. Under this approach, where total expected 'eligible losses' exceeded total 'eligible losses', the modulation factor would be increased to allow greater utilisation of the cap.
44. When compared to the ex-post approach, an ex-post and ex-ante approach provides a moderately higher level of investor certainty because it provides the minimum value of the

modulation factor before the expenditure year. That is, investors could make investment decisions knowing that the modulation factor can only be increased once actual 'eligible losses' are known. This approach would also ensure that the cap is fully utilised.

45. However, it would increase the regulatory burden of the scheme and is unlikely to be able to commence on 1 July 2014 (because legislation would need to be enacted prior to the modulation process).

5. Question

5.3. Is the greater certainty under an ex-post and ex-ante modulation approach desirable, noting the trade-offs (greater regulatory burden and potential delay in starting the scheme)?

~~5.3.~~ A: No!

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6. HOW WILL THE EXPLORATION CREDIT SYSTEM WORK?

46. It is proposed that the incentive would allow companies with exploration expenditure and tax losses in the same income year to provide exploration credits to their shareholders, which will give their shareholders an entitlement to a refundable tax offset.
47. Following lodgement and modulation, a company that wishes to provide exploration credits to its shareholders will:
- reduce the loss it may carry forward from the expenditure year by the amount it wishes to provide to shareholders (its 'renounced loss'), not exceeding its 'available loss';
 - calculate the total exploration credits by multiplying its 'renounced loss' amount by the corporate tax rate; and
 - notify its shareholders of their individual entitlement to a tax offset (before the end of the financial year).
48. Shareholders would claim their refundable tax offset in their tax returns for the year they receive the exploration credits (so they will receive the tax offset two financial years after the relevant year of the company's expenditure).
49. Exploration credits will flow through trusts and partnerships. Corporate shareholders would also receive a benefit, but as with the imputation system, this may not be an offset. Individuals who are not required to lodge tax returns would be able to claim a refund of the exploration credits. Although foreign resident shareholders will receive exploration credits, they will not be able to use them.
50. If a company distributes exploration credits in excess of the permitted amount, the company will be liable to pay tax equal to the excess exploration credits and might also be liable to

penalty tax. Also, it is proposed that anti-avoidance rules targeting streaming and trading will apply as under the imputation system.

51. The Exploration Development Incentive will be voluntary. A company that incurs exploration expenditure could elect to carry forward its losses instead.

6.1 'ELIGIBLE LOSSES'

52. The Exploration Development Incentive will provide shareholders with early access to the economic benefit of losses attributable to the relevant expenditure incurred by a company.
53. As such, the losses that will be eligible for the Exploration Development Incentive ('eligible losses') will be the lesser of a company's relevant expenditure and its loss from the expenditure year. Confining a company's 'eligible loss' to its relevant expenditure ensures the incentive targets exploration for new discoveries. Limiting a company's 'eligible loss' to a company's tax loss for the expenditure year ensures only companies with no taxable income will have access to the scheme.

6.2 CONVERTING TAX LOSSES INTO EXPLORATION CREDITS

54. The Exploration Development Incentive is designed to give shareholders the economic benefit of losses attributable to exploration expenses incurred by a company. This is achieved by allowing an exploration company to provide shareholders with an exploration credit if they reduce the tax losses they may carry forward. However the imputation system and the taxation of company distributions mean, without adjustments, the Exploration Development Incentive could provide shareholders with a greater economic benefit than the benefit of losses.
55. The examples below illustrate why an adjustment could be appropriate. One option is to include the amount of the exploration credit in shareholders' assessable income and make adjustments to companies' imputation accounts.
56. For the sake of clarity, the following examples assume that a new exploration credit regime, similar to but distinct from the imputation system, will apply under the scheme. However, it is possible that the imputation system could be used as the basis for the scheme, depending on law design considerations. Also, the examples assume a corporate tax rate of 28.5 per cent.

Example 1: losses applied against assessable income

57. A company incurs relevant expenditure of \$100 in Year 1. The company decides not to participate in the Exploration Development Incentive, so that it has carry forward losses of \$100. In Year 2 the company receives \$100 income for a discovery. The deduction for the carry forward losses results in nil taxable income. The company pays an unfranked dividend of \$100 to shareholders.

Example 2: losses converted to exploration credits — no adjustments

58. A company has losses of \$100 attributable to expenditure in Year 1. The company decides to flow the benefit of the \$100 through to its shareholders under the scheme (assume the cap is not exceeded, so there is no modulation).

59. The company's losses will be reduced to nil and a \$28.50 credit will arise in its exploration credit account. The company then distributes total exploration credits of \$28.50 to its shareholders, and a corresponding debit arises in its exploration credit account (reducing the balance to nil). Shareholders would be entitled to a total exploration tax offset of \$28.50.
60. In Year 2 the company receives \$100 income for a discovery. The company has no deductible expenditure or carry forward losses, resulting in taxable income of \$100. The company pays its income tax liability of \$28.50, resulting in a \$28.50 credit in its imputation account and leaving it with \$71.50 in cash. The company pays a fully franked dividend of \$71.50, resulting in shareholders receiving a total imputation tax offset of \$28.50.
61. In this case, shareholders would receive total tax offsets of \$57 and \$100 would be included in their assessable income (in respect of the franked dividend) over Years 1 and 2. In contrast, if the company had not elected to convert the loss of \$100 to exploration credits, shareholders would receive an unfranked distribution of \$100 (see *Example 1* above).

Example 3: losses converted to exploration credits — with adjustments

62. To avoid the inappropriate outcomes that arise in *Example 2*, the following rules could operate.
63. Where a company converts losses to an exploration credit, a debit in the company's imputation account will arise equal to the credit that arises in the company's exploration credit account. However, this debit would not be counted for the purpose of calculating liability to franking deficit tax.
64. Also, to ensure the shareholder receives the same treatment as if they had received an unfranked distribution of the equivalent pre-tax amount, an amount will be included in the shareholder's assessable income equal to the exploration credit distributed by the company. This is consistent with the treatment of imputation credits.
65. Assume the same facts as *Example 2*. If the proposed adjustments are applied, shareholders would be entitled in Year 1 to a total exploration incentive tax offset of \$28.50 and \$28.50 would be included in their assessable income. Also, a debit of \$28.50 would arise in the company's imputation credit account when the exploration credits are distributed to shareholders.
66. While an imputation credit arises on payment of income tax in Year 2, there are no imputation credits available because of the imputation debit that arose in Year 1. The dividend of \$71.50 would therefore be unfranked.
67. These adjustments mean that, over Years 1 and 2, shareholders would receive total tax offsets of \$28.50, receive a cash distribution of \$71.50 and include a total of \$100 in their assessable income. This outcome is equivalent to the total unfranked dividend of \$100 received by shareholders in *Example 1*.

6. Question

6.1. Subchapter 6.2 illustrates one way of ensuring the scheme converts tax losses into exploration credits and does not provide a greater benefit. Is there a simpler or better way to achieve this?

A: Weight should be placed on the fact that few of these investments will succeed and those that do will be highly profitable in terms of capital gain that could be quickly realised upon a successful discovery. The examples offered above are not very realistic.

Would a mechanism similar to the following be workable:

1. The exploration company issues a prospectus describing how the funds will be employed to engage in grassroots exploration. A certain degree of flexibility in this should be tolerated to account for the natural program changes that will occur progressively as results are received from the program.
2. The prospectus could contain details of the extent of potential tax credits available for subscribers based upon the exploration program in the prospectus
3. The tax credit is only available to providers of these funds (probably for shares in the company)
4. At the end of each financial year, the company must confirm relevant expenditure on grass roots exploration from the subscribed funds
5. Investors who still hold the shares subscribed for will receive a tax credit for the eligible expenditure.

6.1. I think that would embody most of the elements we are hoping to see and would not create a massive administrative burden for the company, the government or subscribers. I would hope in future years a workable scheme will see much increased funding as the long term winners from this will be all Australians.

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GLOSSARY

| Term | Explanation | Reference chapter |
|----------------------|---|--------------------------|
| ATO | Australian Taxation Office | Chapter 5 |
| Available loss | The loss a company has available to pass through to its shareholders as exploration credits after modulation. | Chapter 6 |
| Eligible loss | The lesser of a company's relevant expenditure and its loss from the expenditure year. | Chapter 5 |
| Expenditure year | The income year the relevant expenditure that may give rise to exploration credits is incurred. | Chapter 3 |
| ITAA | <i>Income Tax Assessment Act 1997</i> | Chapter 2 |
| Modulation factor | The proportion of companies' 'eligible losses' they will have available to pass through as exploration credits, as advised by the ATO after modulation. | Chapter 5 |
| Relevant expenditure | The expenditure that is eligible for the tax incentive: eligible 'greenfields' exploration expenditure. | Chapter 4 |
| Renounced loss | The actual loss a company decides to pass through to its shareholders as exploration credits and the loss it will not be allowed to carry forward. | Chapter 6 |

LIST OF QUESTIONS

| Chapter | Question number | Question |
|---------|-----------------|--|
| 2 | 1 | Will a 'no taxable income test' and a 'no mining activities test' effectively target the measure to junior minerals explorers who are not able to utilise their tax losses? |
| 2 | 2 | How should the 'no mining activities' test operate to ensure the incentive targets small mineral exploration companies? |
| 2 | 3 | Could the approach to restrict eligibility to Australian resident companies that are widely held prevent some junior minerals explorers from accessing the incentive? |
| 3 | 1 | What are the pros and cons of companies distributing exploration credits to all shareholders compared to the alternative approach of requiring new share issues? Which is the preferred option? |
| 4 | 1 | Should the Exploration Development Incentive be available to companies exploring for quarry materials? Why/why not? |
| 4 | 2 | Would the proposed approach of aligning the definition with subparagraph 40-730(4)(a)(i) of the ITAA potentially exclude activities that are, by nature, the search for new discoveries? If so, please provide examples. |
| 4 | 3 | Conversely, would this definition capture exploration activities that are evaluating the economic viability of a known resource? |
| 5 | 1 | Under ex-post modulation, will exploration companies be able to provide investors with an indication of the likely value of the exploration credit based on existing information sources about both their own and the sector's exploration intentions? |
| 5 | 2 | Is the greater certainty under an ex-ante modulation approach desirable, noting the trade-offs (greater regulatory burden, not fully utilising the cap and potential delay in starting the scheme)? |
| 5 | 3 | Is the greater certainty under an ex-post and ex-ante modulation approach desirable, noting the trade-offs (greater regulatory burden and potential delay in starting the scheme)? |
| 6 | 1 | Subchapter 6.2 illustrates one way of ensuring companies that provide their shareholders with exploration credits give up the economic benefit of tax losses. Is there a simpler or better way to achieve this? |