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PRIVATE AND CONFIDENTIAL

Dear Sir/Madam

SUBMISSION - EXPLORATION DEVELOPMENT INCENTIVE: POLICY DESIGN

Grant Thornton Australia Limited (Grant Thornton) appreciates the opportunity to provide comments to Treasury on the Discussion Paper "Exploration Development Incentive: Policy Design" released on 13 March 2014.

Grant Thornton's response reflects our position as a leading advisor to listed, widely held and privately held companies and businesses in the junior exploration and mining sector, as well as to mining service companies assisting this sector.

Our submission includes Grant Thornton's response to the specific questions posed in the discussion paper. We have also attached as an Appendix broader comments which we believe should be considered in designing the Exploration Development Incentive ('EDI').

During the preparation of our submission we also sought the views of our clients and contacts in the sector, a significant majority of whom view themselves as involved in greenfields exploration activities in search of new mineral discoveries. We refer to this in the following paragraphs where relevant.

How to target Junior Minerals Explorers?

Q.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?

Q.2 How should the 'no mining activities' test operate to ensure the incentive targets small mineral exploration companies?

We agree that a 'no taxable income test' should result in the measure being targeted at junior minerals explorers who are not able to utilise their tax losses.

We note that the 'no mining activities test' is in effect a new test not previously foreshadowed in the 'Coalition's Policy for Resources and Energy' paper published in September 2013.

We believe that a complete prohibition on carrying out mining activities may inadvertently exclude some greenfields explorers. There are scenarios where junior minerals explorers involved in greenfields exploration activities, are also involved in mining activities which are insignificant in scale albeit generating cashflow for the business. One example is a junior mineral explorer that has acquired a brownfield site from a third party previously mined for gold, and while exploring solely for greenfield copper deposits, is heap leaching gold tailings from the previous owner.

Accordingly we suggest a de minimus test should apply to the effect that where mining income is below a certain threshold percentage (10% may be considered reasonable) of qualifying expenditure on greenfields exploration, the EDI would be available to the company concerned. This would make the EDI potentially available to a wider group of explorer's whose primary activity is new greenfield minerals exploration – which aligns with the original policy intent of incentivising new investors to invest in exploration companies in recognition of the critical role of a healthy small and mid - tier exploration sector for the future prosperity of the Australian economy.

The exclusion of such de minimus companies from the EDI would limit their ability to raise appropriate capital for their projects, and lead to distortion of the allocation of economic capital based on taxation design.

Q.3 Could the approach to restrict eligibility to Australian resident companies that are widely held prevent some junior minerals explorers from accessing the incentive?

There are examples of unlisted public company explorers who are involved in valid and valuable greenfield exploration, for example proving up resources prior to an Initial Public Offer, and who may be unable to access the EDI under current proposals. These entities are contributing to the further development of the Australian mining industry and the pipeline of new mineral discoveries and should be included as eligible companies, albeit we appreciate that integrity measures will be required in order to prevent the risk of any abuse of the incentive.

Which investors will be able to receive Exploration Credits?

Q.4 What are the pros and cons of companies distributing credits to all shareholders compared to the alternative approach of requiring new share issues? Which is the preferred option?

In relation to the pros and cons of the proposed distribution of exploration credits to all or only new issues, we note the following:

Proposed distribution to all shareholders
Pro – potentially less burdensome in terms of administration.

Con – potentially dilutes the policy intent of incentivising new investment into exploration.

Proposed distribution to new share issues only
Pro – more closely aligns with policy intent to incentivise new investment into exploration.

Pro – would potentially increase the value and effectiveness of the incentive. The overall cap, presuming unusable exploration credits for foreign resident shareholders would be included in the cap, has the inevitable potential to limit the value of the incentive. Limiting the incentive to new shareholders only may result in it being potentially more valuable and thereby more likely to provide the desired incentive to invest.

Con – potentially more burdensome to administer initially and subsequently tracking new shareholders. For example, when would the credit be distributed? Would the credit be granted only to the initial investor, or investors on a particular date if there have been trading of shares since issue? There may be a multi-year time delay between the raising of the capital and incurring eligible exploration expenditure.

When surveyed our clients and contacts indicated that they anticipate raising new funds over the forward estimates period via one of the following : placement of shares, rights issue or a public share issue, and the majority expect that future funding will come from Australian investors, fully or in part.

A majority of those surveyed indicated a preference for the relief to be available to all shareholders. The incentive being available to all shareholders would be more attractive if no cap was introduced as it is administratively less burdensome. However as it is proposed that a cap is to be implemented with the EDI we are of the view that the EDI should be only available to new share issues despite the possible associated increased administration. We have reached this view due to the combined dilutive effect of the modulation process and offering the incentive to all shareholders, which would likely not make the EDI attractive. It appears that limiting the incentive to new share issues is more likely to deliver at least some level of incentive to a smaller pool of investors.

We note that the Canadian flow through shares regime which appears to have a number of similar policy objectives, is available to new investors only and available to them only once in respect of each relevant investment.

'Eligible Expenditure' and 'Greenfields'

Q.5 Should the EDI be available to companies exploring for quarry materials?

Q.6 Would the proposed approach of aligning the definition with sub paragraph 40-730(4)(a)(i) potentially exclude activities that are by nature the search for new discoveries? If so, please provide examples.

Q.7 Conversely, would this definition capture exploration activities that are evaluating the economic viability of a known resource?

We believe the EDI should be available to companies exploring for quarry materials as quarrying materials are important to the Australian economy. For example quarrying materials used in concrete and asphalt aggregates provide a number of benefits for the Australian economy.

We can see a view to exclude quarrying activities due to the dilution effect of the cap and that the cost of exploration for quarrying materials is generally lower.

Addressing question 6 and 7, we note two factors in relation to the type of expenditure in respect of which the EDI incentive may be available:

- eligible expenditure being defined as an inclusive test by reference to subparagraph 40-730(4)(a)(i) only, excluding subparagraph 40-730(4)(a)(ii); and
- the exploration activity being for a purpose aimed at 'grassroots' exploration activities or generative and early stage exploration for new discoveries.

We do not see that the proposed approach of aligning the definition with sub paragraph 40-730(4)(a)(i) will inadvertently exclude activities that are by nature the search for new discoveries on the basis that the definition is inclusive and aimed at the discovery of new resources.

Providing the activity as defined by subparagraph 40-730(4)(a)(i) has to satisfy both the requirements of this subparagraph and the requirement of discovering a new resource, we cannot see the costs of evaluating the economic viability of a known resource being inadvertently included in the EDI.

No questions were directly raised in the paper regarding views on the definition of "greenfields". We note with concern that while the definition of greenfield included at paragraph 21 refers to 'unexplored or **incompletely explored** areas' (our emphasis added), paragraph 22 – 25 refers to an approach that would limit the type of exploration activity that would be eligible.

We believe the definition needs to be wide enough that even on a 'brownfield site' exploration for new minerals previously not explored should be included. Of those responding to our client survey, a significant majority indicated that they would want this type of activity to qualify under an EDI regime.

In addition we have reservations that companies that have an Inferred Mineral Resource are at a stage that is beyond greenfields exploration. Paragraph 21 refers to "incompletely explored areas directed at discovering new resources" and paragraph 24 refers to "location, extent or quality of a new resource". Arguably at the inferred resource stage exploration companies are still at this stage.

As a general comment, a clear definition of what is intended to be qualifying exploration costs under the EDI regime is preferred to ensure the effectiveness of the incentive and to both avoid lengthy correspondence with the ATO and provide companies and investors with certainty. Ambiguity in such areas has been and continues to be a matter of debate between taxpayers, their advisors and the ATO, including what constitutes exploration and feasibility and the parameters of the 'first use' concept. One can anticipate a scenario where a company seeks to provide new potential investors with an indication as to the potential EDI credit that may be available in respect of its planned expenditure – with a view to attracting potential investors – but may hesitate to do so if there is a lack of clarity around what is qualifying expenditure.

Modulation

Q.8 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 their own and the sector's exploration intentions?

Q.9 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)?

Q.10 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)?

Under an ex-post modulation approach we believe that companies will not be in a position to provide investors with an indication of the likely value of the exploration credits based on existing information sources about their own and the sector's exploration intentions. This would require a degree of transparency and information flows that do not appear to be currently available. Currently available information sources do not provide sufficient data on the type of exploration expenditure and in terms of a company being in a position to assess whether an EDI credit may be available, they will not know what other companies propose to pass on to their shareholders and therefore the potential effects of modulation. Furthermore information may be commercially sensitive and published information must satisfy ASX reporting obligations and restrictions.

We suggest that the ex-post modulation process is preferable in view of its lesser administrative burden, that the full value of the cap would be utilised and there would be no deferred implementation date.

Despite at the time they invest there is greater certainty for investors under the ex-ante approach, we do not consider it is desirable after noting the pros and cons of each. The delay in the commencement of the scheme, the potential for companies to overstate their expected losses and the increase in the red tape burden are factors in support of our view. Furthermore, we note that the companies only provide estimates of expected losses to investors whilst the credits are based on actual eligible losses and therefore investor uncertainty still exists with this approach as there is likely to be a variance between estimated and actual losses.

A substantial majority of those that responded to our survey indicated that they would favour the ex-post approach.

Q.11 Subchapter 6.2 illustrates one way of ensuring the 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?

We acknowledge that measures will be required to avoid inappropriate outcomes as referred to in Example 2 and that the proposals in Example 3 would address this. As it appears there will be a delay in investors being in a position to quantify the exploration incentive tax offset due and therefore the amount to be included in assessable income, we assume that appropriate measures will be introduced in relation to self-assessment filing and penalty provisions for individuals.

Should you have any queries in relation to these matters please contact me on 08 9480 2126 or peter.hills@au.gt.com.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Peter Hills
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Enc

Other comments **Appendix 1**

Four Principles of a sounds taxation system

Design of the EDI should be by reference to the four well recognised principles of a sound taxation system: supporting economic growth and efficiency, simplicity, neutrality and flexibility. Focusing on supporting economic growth and efficiency, and simplicity we make the following additional comments.

Supporting economic growth

The need for stimulus into the mineral exploration sector as a platform for the future prosperity of the Australian economy is referred to in The Coalition's Policy for Resources and Energy published in September 2013. Indications are that the junior mining sector is in significant distress and must secure new funding in order to survive, with a significant majority citing a lack of funding as the greatest barrier to exploration for new mineral discoveries. A majority expect future funding to be from Australian investors or a blend of Australian and overseas investors. The proposal to introduce an EDI is therefore a welcome initiative and represents a significant opportunity to attract new domestic investors into the sector and provide much needed funding into long term capital intensive investments.

We note the annual caps and overall $100m cap over the forward estimate period and the initial 3 year period for the incentive. The exploration for new mineral resources is capital intensive and as a result the overall and annual caps risk reducing the potential benefit to investors to be marginal and therefore negate the effectiveness of the incentive. We suggest that the cap should be removed or significantly increased to ensure the policy objective can be met. We also note that the long lead times on exploration activities may result in the proposed initial three year period again reducing the incentive effect of the EDI. For this reason we suggest that the initial life span of the EDI should be five years with a view to it being reviewed and potentially extended for a further five years. The flow on positive effects on the national economy generating crucial export revenue and creating jobs should outweigh the short term cost of funding an expanded EDI.

We also suggest that the EDI should be available to oil and gas exploration and geothermal exploration companies and as they are key contributors to the national economy.

Simplicity

We note that a degree of complexity is inevitable however where possible steps should be taken to increase simplicity and reduce the administrative burden of any new measures. Canada has a tax-based financing incentive commonly referred to as a flow through share. The Canadian scheme is based on a specific type of share which from an administrative point of view may assist in tracking such shares going forward. We suggest consideration be given to whether there are potential benefits to the EDI being allocated to specific 'EDI shares.'