4th April 2014

Manager
Not for Profit and Industry Tax Concessions Unit
Small Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Sent via explorationincentive@treasury.gov.au

Dear Sir/Madam,

Re: Policy Design for the Exploration Development Incentive

Thank you for the opportunity to comment on the policy design aspects of the proposed exploration development incentive.

It is recognised that junior exploration companies play a major part in the discovery of new mineral and petroleum deposits and also the economic activity within the exploration sector. It is understood that while always forming part of the exploration industry, junior explorers increased their presence as a result of the gradual withdrawal of larger companies in the 1990s following the downturn in commodity prices. With the more recent increase in commodity prices (since 2006) exploration expenditure as a percentage of GDP has increased and in 2012 it was similar to the levels experienced in the early 80s[1]. This information suggests that junior exploration companies have been present and quite successful since the mid 90s.

This success has also been in the context of their existing funding model. "Junior explorers rely largely on listed equity to fund themselves because they generally produce little in the way of consistent revenue and so are unable to rely on internal sources of capital"[1].

Given these circumstances, the intention behind the policy design for the exploration development incentive is unclear given the proposed arrangements would normally lend themselves to supporting an infant industry or one that fails to attract investment capital. Furthermore it is concerning, given the situation where around 80 percent of junior resource companies record a net loss in any given year, that the attraction for investment under the proposal would be to claim the operational costs as tax deductions rather than commit investment given the potential for future income generation.

We question the fiscal implications associated with the opportunity cost of forgone taxation revenue generated as a result of providing tax deductibility provisions compared to the possible mining wealth generated from a small number of successful exploring companies which in turn is only captured in part through the company tax provisions applied to the mining company.

Similar abilities for investors to claim tax deductibility for costs associated with the establishment and operation of managed investment schemes existed through the 2000s. While there were some operators that upheld a good intention for agriculture there were numerous schemes that took advantage of the tax arrangements to establish capital intensive start up structures that distorted the market for agricultural land and also quarantined large areas of productive agriculture land into pine and other tree plantations, only to become bankrupt in the process and leave a legacy of unattended forests. The investment decisions in these operations were driven by the taxation arrangements and not on the profit generation of the enterprise. As such there was a misallocation of resources and inefficient investment in the industry that had distortionary effects on the agricultural industry.

---

[1] Williams T (2012) *Exploration and the listed Resource Sector* Reserve Bank of Australia Bulletin – September quarter 2012 available at http://www.rba.gov.au/publications/bulletin/2012/sep/5.html [accessed on 3 April 2014]

We have concerns over the “no taxable income test” as a means for identifying junior explorers. Identifying junior explorers by way of assessing their taxable income provides no incentives for those junior explorers to generate a profit given the resulting impact would be an inability to attract investment. It would appear a perverse outcome that the policy actively encourages junior exploration companies not to make a profit from the point of attracting investment furthermore reducing the impact of the tax deductibility of the operating expenses for the potential investors.

Furthermore it is unclear why junior exploration companies are being targeted. It is presumed that one of the objectives of this program is to encourage investment in exploration and thereby identify new mineral deposits for mining. Whether exploration companies are junior or longer terms operators it would seem irrelevant to the expected overall objective of encouraging investment in exploration activities.

NSW Farmers has a number of concerns in relation to the implementation of this scheme, mainly around the unintended consequences for our members. We are primarily concerned that the introduction of a scheme such as this will lead to a sharp increase in the number of small, shelf companies, that are seeking access to landholders property for the purposes of exploration.

Much of this exploration will likely be very speculative in nature. The policy design paper has focused too much on the taxation and monetary aspects of the incentive and we are alarmed to see that there is virtually no discussion on the impacts to rural landholders.

In summary, some of the key issues that need to be addressed and discussed are:

- Given that the scheme is likely to increase the incidences of exploration companies seeking access to private land, what, if any, measures will be put in place to compensate landholders for their time spent negotiating access arrangements as well as any legal fees that they may incur. The NSW legislative provisions will allow for some of this (eg. legal fees), but not all. This needs to be addressed on a state-by-state basis.

- Additionally, given the increased incidences of access to private land under that the scheme, what analysis has been done on the liability risks to landholders as a result of having third party explorers on their property? Particularly given the case that these companies will be very small in nature with little to no cash reserves. Again, in NSW, the state based legislation will cover some aspects of this, but the policy design in the discussion paper does not cover this at all.

- We note that final implementation of the policy will be determined in consultation with peak industry representatives. Rural landholders will be the most important stakeholder affected by the implementation by a policy such as this. As a result, we fully expect that relevant landholder representative organisations, such as the National Farmers Federation, will be included in this group and we seek confirmation of this.

Yours Sincerely,

Fiona Simson
President