

Association of Mining and Exploration Companies (Inc)

Assn No. AO810217E ABN: 33 362 864 696

1 February 2009

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To whom it may concern

AMEC Submission to the Draft R&D Tax Credit

The following comments are provided in response to the *Exposure Draft – Tax Laws Amendment (Research and Development) Bill 2010* (“draft R&D legislation”) and associated Explanatory Materials (“EM”) released on 18 December 2009.

Association of Mining and Exploration Companies Inc (“AMEC”) is extremely concerned about a number of principles proposed in the draft R&D legislation which we believe fail to properly recognize and reward the genuine R&D activities undertaken by junior and mid-sized exploration and mining companies.

Our key concerns include:

- The changes to the definition of core R&D activities in section 355-25(1) of the draft R&D legislation, AMEC believes that the test should be novelty **or** high levels of technical risk;
- The new definition of “supporting R&D activities” in section 355-35 are overly restrictive and unfairly target the mining industry;
- The feedstock rules detailed in subdivision 355-G require amendment to include additional quarantined expenditure; and
- The amendments to the multiple sale test for software claims should be removed.

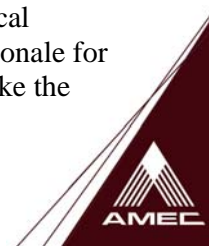
It is our opinion that the cumulative impacts of the above provisions undervalue the R&D efforts of junior and mid-sized exploration and mining companies and significantly diminishes the incentive for resource companies to invest in R&D. The draft R&D legislation as it stands disadvantages the mining industry to the point where there is a danger that R&D Tax Credit will be inaccessible to the resource community and the added complexity introduced for small to medium companies (“SME’s”) will deter these entities from accessing the R&D Tax Credit.

Core R&D Activities

Considerable Novelty

The novelty test detailed in the EM imposes a higher benchmark for innovation than the current legislation. Para 2.22 states that degree of novelty must be “considerable” as opposed to the current requirement that innovation must be “appreciable”. The EM further states that a “mere logical progression from existing knowledge” will not satisfy the considerable novelty test. The rationale for this restriction is that spillover benefits are unlikely to result for “merely being the first to take the next obvious step.”

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In industry companies are usually restricted from taking “the next obvious step” due to the high levels of technical risk or significant technology gaps associated with that progression. When a company does take on this challenge and achieves the next technology progression significant spillover benefits will result for the industry, as shown in the below example. The initiative taken by such companies should be encouraged and rewarded by the R&D Tax Credit.

Explorer Co uses 3D seismic to identify possible targets for further exploration activity, as also used by the wider industry. As 3D seismic tools were initially developed for the offshore oil and gas industry they are more suitable to investigating simple structure geology. The mining industry currently has significant difficulty obtaining clear 3D seismic when applying to complex geological structures due to the seismic frequency ‘bouncing’ in random angles and preventing full data sets from being obtained.

Explorer Co believes that by adjusting the frequency of the seismic wave for different geological structures and densities higher resolution data can be obtained. Although this is the ‘next obvious step’ in developing the technology other mining companies have not embarked on this project due to the considerable knowledge gap due to the multitudes of different possible geological structures and combinations, cost associated with undertaking the development and lack of technical expertise and company resources during the current economic cycle.

If Explorer Co is successful they will have greater ability to locate economic mineral deposits that will result in development of commercial mine sites, the following spillover benefits will result:

- *Job creation;*
- *Additional export earning;*
- *Additional royalties and taxes being paid; and*
- *Development of additional knowledge within the company which will transfer to the wider industry via staff movements or sale of technology development.*

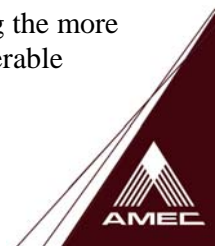
Under the proposed R&D eligibility criteria this project would not be rewarded by the under the R&D Tax Credit and would reduce the incentive for Explorer Co to undertake this R&D project.

The “And” Test

Core R&D activities will be required to involve considerably novelty AND involve high levels of technical risk. This shift away from the current requirement of core R&D activities to be innovative OR involve high levels of technical risk, we believe, sets an overly stringent criterion that will excessively limit the benefits available to small to mid-sized miners and resource service providers.

As detailed above the “considerable novelty” test will clearly eliminate genuine R&D efforts from being rewarded under the R&D Tax Credit, by coupling this requirement with high levels of technical risk the number of eligible R&D claimants from the SME sector will be significantly reduced. This is in direct contrast with the policy objective of the new R&D Tax Credit.

The “and” test also add an additional layer of complexity to the claim process where there is no or little case law and material to ascertain whether the “and” test is met. The burden of meeting the more stringent benchmark is compounded by the uncertainty of determining whether both considerable novelty and technical risks exists.



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Furthermore, the objective of the R&D Tax Credit is to subsidise and encourage R&D to target the spillovers generated by the new knowledge being developed. The “and” test set in the draft R&D legislation tightens the core R&D activity definition to the point where high value R&D is likely to be ineligible and would therefore limit the spillover benefit that the program is seeking to support. Significant spill over benefits can result from projects that overcome high levels of technical risk without considerable novelty, or with logical progressions of technology development.

In addition, in *venturousaustralia – building strength in innovation*, the report by the Review of the National Innovation System, the current “or” test was not raised as access point for low value R&D.

AMEC recommends that the eligibility requirement for the new R&D Tax Credit is changed to require considerable novelty **or** high levels of technical risk.

Supporting R&D Activities

Dominant Purpose

The draft R&D legislation puts forward the concept of dominant purpose in its definition of supporting R&D activities in s355-35(1) which preclude activities that are taken for dual or mixed purposes from being eligible.

Where possible, businesses often undertake tasks for more than one purpose to maximize the return on the funds spent. For smaller entities, the requirement to optimize the return from any given activity is of greater importance as they cannot afford the luxury of pure R&D activities without a commercial objective driving the exercise.

The dominant purpose concept does not allow for the commercial reality that companies operate under and in fact, penalizes good business practice. For small and growing mining and mining services companies, this provision is especially harsh and commercially counter-intuitive.

AMEC requests that the word ‘dominant’ is replaced with ‘a’ purpose to ensure SME enterprises are able to recognize the costs associated with undertaking core R&D activities under the R&D Tax Credit.

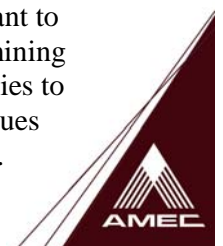
Extension of Exclusion List to Supporting Activities

The extension of the exclusion list to supporting activities is a compounding factor which coupled with the more stringent eligible requirements, is a disincentive for companies to access the R&D Tax Credit. The additional exclusions will result in a significant reduction in the value of R&D Tax Credit that can be accessed, which coupled with the higher administration burden of accessing the concession due to the new complex legislation will reduce the number of AMEC’s members that will pursue the R&D program.

Exclusion of Exploration-type Activities

AMEC believes that the mining industry has been unfairly targeted by the new list of excluded activities which are now expanded to exclude many necessary supporting activities of any mining R&D program. For example, identifying and understanding the resource is critically important to mining companies and forms the first stage in any mining project. Consequently, mining / mining services companies will invest in improving or developing new techniques and/or technologies to identify, better understand and exploit their deposit. The testing and trialing of these techniques would no longer be supported under the R&D Tax Credit due to the expanded exclusion list.

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A number of genuine R&D claims require exploration or drilling activities to test their R&D hypothesis and as a result, the insertion of exploration-type activities in the list of excluded supporting R&D activities unfairly targets the resource industry.

Exclusion of Software Development Activities

Similarly, the exclusion of software development activities from the supporting R&D activities list will mean activities like sophisticated geological modeling and processing analysis will not be eligible. Legitimate R&D claims from mining / mining service companies will be disallowed under this excluded activities list.

These changes to supporting R&D activities separately and in totality offer little incentive for small to medium companies to investigate and invest in creating, developing and/or testing new techniques and technologies. AMEC requests that the exclusion list be restricted to core R&D activities and that the new software inclusions be removed.

Feedstock

Feedstock Amount – Method Statement

The feedstock adjustment set out in s355-450(1) is all-encompassing and does not exclude activities unrelated or distant to the inputs. The reduction of the R&D deductions by the feedstock amount as it currently stands in the draft R&D legislation is harsh and difficult to calculate which would be a deterrent for companies, in particular, smaller companies with less resources to spare. Additionally the new requirement to determine a “market value” will add complexity into the production chain where a value may be difficult to discern.

Feedstock and Quarantined Activities

Certain expenditures will be “quarantined” from the Feedstock calculations; we believe that the list of quarantined expenditures should be extended to include the following:

- pre-feasibility and feasibility activity
- design work undertaken prior to financial investment decision
- commissioning activity
- salary expenditure throughout the project life
- overhead expenditure
- development of intangible assets
- development and testing of prototype
- consumables

Additional Complexity

Several areas introduced by the R&D Tax Credit add to the complexity of applying eligibility rules, calculating claim values and additional administration costs to making an application. These complexities deter small companies with limited resource from accessing the R&D incentive and counter the policy objective of providing enhanced incentive to SME's.

Movement away from Tax Law

Expenditure Incurred To an Associate

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The tax act has specific anti-avoidance provisions to cover situations where a company may seek to manipulate a situation for a tax advantage. For this reason AMEC does not see the need to complicate standard accounting practices to recognize payments to associates on a cash basis where a company reports under an accruals method.

Prepayment Provisions

Again the movement away from standard income tax practices to account for prepayment when they are consumed rather than when incurred will further complicate accounting practices for companies and lead to higher error rates with companies tax returns.

AMEC recommends that the prepayment and associate rules are removed from the Tax Credit legislation.

Reduced Access to Refundable Offset

Grouping

Tax Credit grouping provisions have now been aligned with the small business entity provisions under Division 328, requiring the aggregate turnover of “connected” entities to be included when considering eligibility of the refundable R&D Tax Credit. This changes the grouping requirement from a control test exceeding 50% ownership of an entity to being ‘connected’ and therefore grouped at 40%. Not only will this change exclude more small to medium enterprises from access to the Refundable Tax Credit, a guiding policy objective being redistribution of benefit towards SME entities, it also adds complexity the legislation and can result in a company being connected with two entities who each control 40% of more of the entity.

This change will directly impact many of AMEC’s members and reduce access to the Refundable Tax Credit. AMEC recommend that the “connected” test is removed and replaced with the old ‘grouping’ rules.

Eligibility Requirements

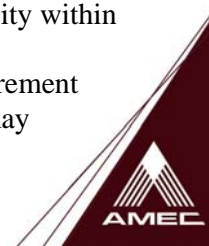
The PKI test introduced in the draft R&D legislation complicates the claim process and is unnecessary. The PKI test requires the experimental activity to have a “dominant” purpose, which outlined above is rarely the case in the mining industry. Additionally the PKI test will not allow the development of known technology to be considered experimental, even where the knowledge does not exist to the organization. This penalizes small companies who may not be able to afford to purchase existing technology required as a foundation for a project, but have the technical expertise to internally develop the technology.

AMEC recommend that the PKI test is removed from the EM.

Added Administration Complexity

Separation of Core & Supporting Activity

The new Registration requirements require the separation of core and supporting R&D activity within the R&D Application. The mining industry does not naturally dissect a project into these classifications, but rather looks at all activities necessary to achieve an objective. This requirement imposes greater administration burden upon SME’s completing the Registration from and may discourage companies from accessing the R&D Tax Credit.



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Impact on Dividend Franking Account

The new R&D Tax Credit impacting upon company's dividend franking account ("DFA") adds complexity to the reporting requirements of the organization and can lead to higher error rates. The complex rules preventing a DFA from decreasing below zero requires companies to have a separate mechanism for carrying forward the DFA 'liability' due to accessing the R&D Tax Credit. Unless a mechanism is introduced for the Tax Office to advise companies of the correct treatment to their DFA, following lodgment of their annual tax return, there is considerable risk of companies incorrectly paying franked dividends in future years.

AMEC recommends that these administration rules are simplified to assist SME's access the new R&D Tax Credit.

If you would like to discuss AMEC's submission, please call me on 08 9225 4399.

Yours sincerely



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Association of Mining and Exploration Companies Inc

