ASX

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Manager
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The Treasury
Langton Crescent
PARKES ACT 2600

EXPLORATION DEVELOPMENT INCENTIVE: POLICY DESIGN

ASX supports the Government's proposal to establish an Exploration Development Incentive to encourage the funding of mining exploration. Continued investment in exploration for new mineral deposits will support the long term health of the mining industry and the Australian economy.

Over a number of years there has been an underlying weakness in the level of 'greenfield' exploration necessary to guarantee the sustainable, long-term production capacity of the industry. This weakness was even evident during the strong production and export performance of the sector during the commodities boom.

Failure to address this weakness over time would continue to see an increasing proportion of global exploration expenditure being directed overseas to Australia's competitors in Latin America, Canada and Africa. The end result would be fewer discoveries of new mineral deposits, which in turn would lead to lower production capacity and diminished global competitiveness over the longer term.

Greenfields exploration is largely the province of junior exploration companies because they can do it more economically and effectively than the large producers. The juniors effectively provide the pipeline for the larger companies who will often acquire prospective tenements from juniors once they have been discovered and turned into brownfields prospects.

The current tax system acts as a disincentive to greenfield exploration by junior companies. Tax incentives are in place to encourage risky exploration expenditure. These allow an immediate write-off for certain exploration related expenditures. This form of tax incentive does not work effectively for the vast majority of the explorers which are junior exploration companies that have little or no taxable incomes.

Removing this distortion, by providing more timely access to the tax benefit directly to shareholders, will help support mining activity in coming decades, and will help address the prospect of Australia's long-term self-sustainability in mineral production.

ASX has worked with industry bodies over number of years to design models appropriate for the Australian market to address the challenges facing small explorers. These have been considered by previous Governments.

The Exploration Development Incentive will go some way to address this distortion in the tax system.

The industry is best placed to provide comments on detailed technical design features of the scheme raised in the discussion paper. There are two sections of the paper that ASX would like to comment on.

Identifying junior minerals explorers which qualify for the incentive

It is proposed that, to ensure the integrity of the scheme, it would be limited to Australian resident companies that are 'widely held' as defined in the Income Tax Assessment Act 1997.

Policymakers could consider whether to supplement that definition with the company being required to be a 'disclosing entity' as defined in Section 111AC of the Corporations Act. The significance of being a disclosing entity as set out in Sections 111AN to 111AQA of the Corporations Act include obligations to prepare financial statements, including half and full year accounts and comply with the continuous disclosure requirements of the Corporations Act. These additional requirements would facilitate greater transparency in the application of the proposed tax credit.

All shares or new shares?

On the issue of whether the concession should be available to all shareholders of the entity or be restricted to only those that supply 'new' equity capital ASX notes that there are trade-offs involved.

ASX recognises that providing the benefit to all shareholders of the company would be administratively simpler for the company, regardless of the other design features of the Exploration Development Incentive. However, such an arrangement would dilute the impact of the incentive in attracting new capital to the company.

In contrast, ring-fencing the incentive to shareholders that contribute additional capital would better align it with the objective of the measure but will likely raise a number of issues that may affect the efficacy of the measure.

If the measure is designed so that the tax benefit is 'attached' to the share and can be transferred when the share changes hands then it is likely the company would be required to issue a separate class of shares. This may raise a number of practical questions depending on the company's particular circumstances. These questions may include whether: the company will need to get shareholder approval for the issuance of a new class of shares; what disclosure requirements would need to be met (eg a cleansing notice); whether some types of capital raising mechanisms may be problematic; and the impact on the liquidity of trading in the ordinary shares of the company. A new class of shares may also act as an impediment to a takeover thereby affecting the efficiency of capital markets

None of these issues should be a serious impediment to the scheme but they will affect its attractiveness.

The final decision between the two options is very much dependent on the other design features of the Exploration Development Incentive.

ASX believes that a well-designed Exploration Development Incentive can play an important role in attracting capital to high-risk greenfield investment projects. This will have broader benefits for the economy over time. The investment incentive model might also be able to be extended to other 'high-risk' industries in which Australia has strong potential, such as biotech and life sciences.

ASX has recognised the need to support investment in the mining sector, taking measures that should assist listed companies (particularly mining small mining companies) to access equity capital. This includes:

- updated disclosure requirements for reserves and resources in the mining and oil and gas industries to provide relevant information to investors to enhance their confidence in the quality of information being provided by listed companies; and

- improved flexibility for small and mid-cap companies to raise capital through placements and also reduced the standard timetable for traditional rights issues from 26 to 19 business days, making such offers a more attractive tool to raise capital.

ASX would welcome the opportunity to work with the Government and industry to design a model that is practical and fiscally sensible, and achieves the correct result – directing investment where it is needed most – to exploration for new deposits to ensure the future productive capacity and international competitiveness of Australia's resources sector.

If you have any questions on ASX's submission please contact James Rowe, Manager Listings (Perth), tel: 08 9224 0001, email: james.rowe@asx.com.au; or Gary Hobourn, Senior Economic Analyst, tel: 02 9227 0930, email: gary.hobourn@asx.com.au.

Yours sincerely,

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