Tel: +61 7 3237 5999
Fax: +61 7 3221 9227
www.bdo.com.au

Level 10, 12 Creek St
Brisbane QLD 4000
GPO Box 457 Brisbane QLD 4001
Australia

Via email: ExplorationIncentive@treasury.gov.au

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

4 April 2014

Dear Sir/Madam

SUBMISSION - EXPLORATION DEVELOPMENT INCENTIVE

RESPONSE TO POLICY DESIGN PAPER

We have addressed our responses to the discussion paper questions in the order in which they have been presented. Initially however we make the following general observations:

- The policy paper, while targeting junior explorers does not address a fundamental problem currently facing a number of junior explorers, that is, the problem of initial raising of funding and seed capital (as the scheme is targeted at already widely held companies);
- The policy design paper makes no mention as to how the current Research & Development Tax Incentive will be impacted by the Exploration Development Incentive (EDI). If the electing to utilise EDI does have a negative impact on R&D Incentiveapplications, the takeup may be limited. Many exploration clients utilise R & D Tax Incentive system as part of their current cash flow funding, especially in the current economic conditions;
- The policy restriction of limiting the incentive to exploring for minerals is positive. The bigger challenge faced in the Queensland junior explorer industry is the lack of necessary infrastructure close to 'greenfield' exploration. That is, currently there is a lack of rail, energy connection and low port capacity. We envisage that, in the Queensland Resources Sector at least, there will be a slow take up.

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?** We believe a 'no taxable income' and a 'no mining activities' test would effectively target junior explorers.

Having said this, it is imperative that 'mining activities' be adequately defined in order that companies are not inadvertently not caught out under this exclusion.

We suggest that companies deriving assessable income from mining activities need not necessarily be excluded from the exploration credit scheme. Imposing an assessable income test may unnecessarily exclude companies that

- Conduct mining activities on a relatively small scale; or
- Commenced mining activities in the relevant income year.

In addition, if an 'assessable income' type test was implemented, it would need to be constructed so as to exclude, for example, interest earned on funds raised or held on deposit to meet future exploration expenditure

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

There is a risk that small mineral exploration companies may be excluded from accessing this incentive where they are undertaking mining activities in conjunction with exploration activities. Given the nature in which the speed in which exploration tenements are advanced there maybe times where certain exploration work is being undertaken in a taxpayer group at the same time in which a mining is being developed. At the time a tenement is transitioning from exploration to development this incentive would effectively exclude them from passing on the exploration losses to their shareholders

We believe that an approach similar to the research and development tax offset application is appropriate i.e. a project based application.

As mentioned above, it is imperative that 'mining activities' be adequately defined in order that companies are not inadvertently not caught out under this exclusion.

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?**

Restricting the amounts available to only Australian resident companies that are widely held could prevent some junior mineral exploration companies from accessing this incentive as it is not uncommon that a start-up is **not** listed in the early stages of the company lifecycle. Restricting the incentive to only widely held companies will limit the application of the incentive to these privately owned companies (that arguably could benefit from this incentive the most).

In defence of this approach though those small exploration companies which are widely held are generally listed on the ASX, are required to comply with JORC reporting requirements, are required to issue quarterly exploration reports and are audited. This therefore ensures that there is integrity and robustness in the eligibility criteria for accessing the incentive to legitimate exploration companies. This though would exclude those companies that are in the early stages of the company lifecycle as noted above.

It may be feasible to develop a set of additional criteria for non-widely held companies to access the incentive. These criteria would require a company to prove certain feasibility and independence requirements before being able to access the incentive. It is noted that when applying for exploration tenements that companies are required to submit an industry plan to the State Authority issuing the exploration licence which in itself provides legitimacy to the activities.

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?**

We believe that the preferred option is to distribute exploration credits to all shareholders. This is broadly due to the administrative, compliance and regulatory burden that would likely result to junior explorers if the incentive was available solely to new investors.

The pros and cons of each options are listed below:

All shareholders:

Pros – Reduced compliance costs. Administratively it would be simpler to distribute tax credits to all shareholders that already exist at the date exploration credits are distributed. This reflects the risks that all shareholders have carried to the date of passing on the incentive, regardless of the point in time in which the exploration activity was undertaken and funded. It is noted that there is not a neat lineal relationship between the share raising and the undertaking of greenfield expenditure.

Cons – Dilution of benefit of the incentive credit, hence the potential to dissuade new investment.

- Issues may arise where companies have different classes of shares
- There may be issues under Corporations Law. For example companies may need to disclose in Product Disclosure Statements that there is no guarantee of exploration credit distribution attached to shares.

New shareholders

Pros – Would encourage new money to be invested into the project by way of new share issue.

Con's – Equity raising costs concerning compliance with requirements

- Costs associated with maintaining an extra share register
- Anti-avoidance provisions may need to be developed to prevent shareholders from realising shares and then re-investing to obtain the tax credit, thus adding further compliance burden to junior explorers.
- Overlooks shareholders who have already invested;
- Would more than likely require records to establish the amount of loss over part of the income year where new shareholders are introduced during the year

4	1	**Should the Exploration Development Incentive be available to companies exploring for quarry materials? Why/why not?** Yes, the incentive should be available to companies exploring for quarry materials, as long as these materials differ to those initially quarried for. This part of the industry is a major contributor to infrastructure resources which are directly and indirectly linked to the mining industry. Accordingly there is benefit in extending the incentive to these activities
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.** This definition would severely narrow down resources to which the incentive would apply. Given that the incentive is to target junior explorers it is understandable that a narrow definition be adopted. Industry should be consulted to detail an accurate and industry accepted determination of what constitutes greenfield's exploration expenditure. As the term is not defined there are a number of anomalies which may arise in the interpretation of what defines greenfields. It can include tenement exploration that has had only initial geomapping or tenement areas that have only had a high level desk reviews. Under both examples there would be existing exploration activities as defined without any drilling or other real disturbance on the tenement. Accordingly close consultation with industry is required
4	3	**Conversely, would this definition capture exploration activities that are evaluating the economic viability of a known resource?** The suggestion regarding mineralisation that has been classified as an Inferred Mineral Resource or higher under the Joint Ore Reserves Committee (JORC) Code should be further discussed with industry. Aligning the definition of greenfields activities with the Inferred definition

		is quite limiting. In addition, the definition of greenfields in paragraph 21 of the policy paper refers to ‘incompletely explored’ areas. Further consideration of what constitutes ‘incompletely explored’ should be undertaken.
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?** The “modulation” process is a key part of the delivery of this tax policy objective. Evidence of good tax design is to keep this process simple. The ex-post modulation option, in comparison with other methodologies would be the simplest in terms of compliance. In terms of driving investment, the availability of tax credits to investors would likely be one consideration of many for a sophisticated investor. While there would certainly be some uncertainty as to the tax credit return to shareholders under this methodology, this would not outweigh the benefits to the junior explorer in terms of administrative simplicity and lesser regulatory burden.
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)?** Given the limited funding available under the modulated scheme, there is greater uncertainty as to the final return under the ex-ante modulation approach. In addition, greater regulatory burden would potentially outweigh any benefit under this approach.
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)?** Again, it is felt that the benefits under this approach are outweighed by the greater increase in compliance and regulatory burdens.
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?** We agree that under the proposed credits scheme that this would be the best way to achieve this. However, there is some question as to how the utilisation of losses under this scheme would interact with other aspects of the ITAA, particularly the R&D Tax Incentive. Perhaps in terms of overall policy design to provide certainty and assistance to junior explorers, a merits based grants system could be considered. This would be both cheaper, and administratively simpler. It

may be able to be administered by another government department more in tune with mining industry issues (such as AusIndustry).

It is noted that widely held exploration companies already report to the ASX and other industry bodies on their quarterly and annual exploration expenditure. Given these documents for these type of companies are required to meet governance requirements and are audited they should form part of the reporting requirements for this incentive to simplify this process.

Should you have any questions in relation to the above please do not hesitate to contact me on (07) 3237 5992.

Yours faithfully

Don Collins
Director

Document2