
Welcome incentive for investors in greenfields mineral exploration

1 November 2017

In brief

On 19 October 2017, the Government introduced a Bill into Parliament for a Junior Minerals Exploration Incentive (JMEI), to replace the Exploration Development Incentive (EDI), which expired this year. The JMEI was developed in close consultation with industry, and is designed to attract and encourage investment in small exploration companies undertaking greenfields mineral exploration in Australia. In essence, the JMEI allows eligible companies to ‘give up’ their exploration tax losses to investors in the form of a tax offset.

Critics of the EDI argued that its operation was relatively unattractive, pointing to the possibility for the benefit to be diluted by the passage of time between making the investment decision and receiving the tax offset, the allocation of the offset to all shareholders, and the ‘modulation factor’.

In response to this, the JMEI is only available to investors that purchase newly issued shares and is allocated to eligible exploration companies on a *first come, first served* basis (with no modulation factor). Eligible companies can apply for the JMEI in advance of conducting capital raisings. Effectively, this means that when making investment decisions, investors should be aware of the likely magnitude of exploration credits to be allocated.

The JMEI will apply for four years, starting from the 2017-18 year. A transitional rule will apply for the 2017-18 income year, which will require an application for an allocation of credits by an eligible exploration company to be made on or after 1 February 2018 but before 1 March 2018. As the new incentive is designed to be a ‘first come, first served’ process, we encourage small exploration companies that are interested in applying to start planning to ensure readiness by February 2018.

In detail

Who is eligible and what is the incentive?

Broadly, companies who carry out *greenfields* mineral exploration in Australia will be eligible to apply for the new incentive. This definition is very similar to the restrictions for the EDI. Companies, or an affiliate of an entity, undertaking extraction activities of minerals or exploration of petroleum or quarrying materials will not be eligible for the incentive.

Like the EDI, the JMEI allows companies to effectively forfeit tax losses to create and issue exploration credits to investors. Investors will then receive an exploration credit in the form of a refundable tax offset, or franking credits where the investor is a corporate tax entity (except a life insurance company). Despite the similarities, there are key differences between the EDI and the JMEI that arguably improve the attractiveness of the incentive:

- The JMEI requires that exploration credits are only issued to investors that participate in new capital raisings rather than to all shareholders. In our view, this will result in the scheme being more directly aligned to the objective of the incentive, as the credits will provide value to new investors when making decisions to invest, making greenfields exploration investment more attractive.
- The JMEI adopts a *first come, first served* basis, rather than credits being allocated by reference to a modulation factor. Furthermore, an application for credits can be made in advance of any new capital raising. This provides a significant advantage for explorers who are allocated credits by the Commissioner of Taxation (the Commissioner) to embark on a capital raising, stating that they have the ability to provide credits to investors.
- Any unallocated exploration credits in one income year can be transferred to the following income year, and allocated to participating investors.

There are limitations to the amount of exploration credits able to be allocated to a particular exploration company by the Commissioner. The credits allocated must be the lesser of:

- The company's estimated greenfields minerals expenditure for the income year, multiplied by the corporate tax rate that it expects will apply for that year (likely to be the lower 27.5 per cent rate);
- The company's estimated tax loss for the income year, multiplied by the corporate tax rate that it expects will apply to it for that year; and
- An amount equal to 5 per cent of the annual exploration cap for that income year (or other prescribed amount). This translates to AUD750,000 for the 2017-18 income year.

Annual caps on allocation

The JMEI will apply for four years, starting from the 2017-18 year, providing a total of AUD100 million in tax credits for eligible exploration companies.

The Commissioner is prevented from allocating exploration credits once the annual exploration cap for an income year is reached:

- AUD15 million for the 2017-18 income year
- AUD25 million for the 2018-19 income year
- AUD30 million for the 2019-20 income year; and
- AUD30 million for the 2020-21 income year.

As these caps are applied on a first come, first served basis, companies will need to be well prepared to submit an application to receive an allocation, especially for the 2017-18 income year where applications are to be made on or after 1 February 2018 but before 1 March 2018.

If any part of the annual exploration cap remains unallocated for a year by the Commissioner, this can be carried forward to increase the cap for the next income year (except for the 2020-21 income year).

Issuing credits to investors

Exploration companies that are allocated credits by the Commissioner can issue those credits to eligible investors that make an investment after the time the credits are allocated, but before the end of the income year. Credits can however be issued in that income year, or the year after.

The credit is limited to the lesser of the company's eligible greenfields expenditure for the income year, and the company's tax loss for that year.

Practically, an exploration company with credits is likely to determine the issuing of credits after year end, but those credits will be issued to investors in respect of the income year in which the exploration activity occurred.

For example, if an investor makes an investment on 20 November 2017, and those investment funds are spent on greenfields minerals exploration by the company before 30 June 2018, the investor can claim the credit in their 30 June 2018 income tax return, even if the company does not determine the amount of credits to be issued until, say, 30 September 2018 (when it has determined its tax loss for the year).

If a company over allocates credits, or has allocated them inappropriately, the company (not the investor) may be subject to excess exploration credit tax.

How to apply

An application needs to be submitted online to the Commissioner of Taxation. The application needs to include an estimate of the company's greenfields minerals expenditure, tax loss and corporate tax rate for the income year.

Outside of the first transitional year of 2017-18, the application needs to be made in advance, between 1 June and 30 June in the preceding financial year that corresponds to the income year for which the allocation is requested. This includes entities that have substituted accounting periods. As noted earlier, for the 2017-18 income year, the application will need to be made on or after 1 February 2018 but before 1 March 2018.

Applications will be subject to an integrity measure whereby the Commissioner may refuse the application. It is understood that estimating expenditure and tax losses in advance is imprecise however, if the Commissioner determines, upon review, that the credits requested are significantly overstated or potentially too ambitious, the Commissioner can refuse the application. It is important to note that the onus will fall to the exploration companies and not its investors.

The takeaway

Overall, it appears that the new scheme is now more closely aligned to the Canadian 'flow through share' scheme, which has been operational for a number of years. The value of the credit should increase in the hands of the investor at the time of investment, relative to the EDI. In our view, this should make the JMEI more successful than the EDI in encouraging investment in Australia's mining industry.

Exploration companies who are interested in applying for the incentive for 2017-18 should make sure they are adequately prepared to submit an application in February 2018.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Matthew Budge, Perth
+61 (8) 9238 3382
matthew.budge@pwc.com

James O'Reilly, Brisbane
+61 (7) 3257 8057
james.oreilly@pwc.com

Tamika Cullen, Sydney
+61 (2) 8266 0397
tamika.cullen@pwc.com

James Puchlenko, Adelaide
+61 (8) 8218 7073
james.puchlenko@pwc.com

Michael Taylor, Melbourne
+61 (3) 8603 4091
michael.taylor@pwc.com

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