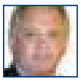
Tax incentive may fall flat

Policies signal Australian government preference for the 'right' kind of research



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The Australian government offered an incentive to invest in mineral exploration companies in its budget on May 13. The uncertain impact of the modest tax handout is unlikely to revive exploration spending, if that was the government's intention.

In its first annual budget since being elected in September, the new Australian government announced an exploration development incentive. The government will provide refundable tax offsets up to a total value of A$100 million (US$92 million) to Australian resident shareholders of companies conducting greenfield mineral exploration. The incentive will operate over the three years to June 2017.

The initiative is a commitment from the 2013 election policy manifesto of the Abbott government written at a time when parties were still jockeying for sectoral support. The measure now sits at odds with more recent strident calls from senior ministers for business to lessen its reliance on government assistance.

The Australian Bureau of Statistics (ABS) has estimated that total spending on non-petroleum exploration in Australia in 2013 was US$2.3 billion. This was a drop of US$1.3 billion from the peak in spending over the 12 months to June 2012. A tax benefit capped at US$23 million in its first year appears of little consequence in this context.

To sharpen its focus, the proposed measure will only cover greenfield spending and, within that, only spending by small companies. Of the total spent on exploration in 2013, the ABS has estimated the amount going on new deposits to have been US$385 million or 17% of the total. It is unclear how much of this will qualify as coming from small companies. To be defined as "small" a company cannot have a taxable income or existing mining activities.

The value to individual investors of the new measure will remain uncertain well beyond the planned July 1, 2014, start-up date. Companies will have the option of passing on the newly available exploration expenditure credit or carrying forward the expense as a tax loss as they do now. Investors buying shares will only know whether they are in line for the new benefit if the company in which they are investing happens to have made an explicit election about the treatment of their exploration spending by the time of the share purchase. Companies could wait until the end of each tax year to make a choice.

Eligible spending must occur within Australia. Having to give investors advance commitments about their Australian spending may prove impractical for companies operating both within and outside Australia. To be able to file accurate returns to the Australian tax authorities about likely claims would also require companies to keep track of the tax paying status of their shareholders, imposing a further administrative burden.

Decisions on some of the details have still not been made. The Australian treasury and the Commonwealth Department of Industry released a discussion paper in March requesting industry input on a range of questions thrown up by the government's election policy commitment. One of the outstanding matters was whether an entitlement to a tax benefit should accrue only to new share subscriptions or whether purchases on secondary markets should also be eligible.

The government is also yet to clarify whether there will be a holding period test. Without that, a trader could simply hold shares for 24 hours on the last day of the tax year to potentially obtain a tax benefit. This would sit oddly with shareholders who had subscribed new money during the year to contribute directly to higher exploration spending, but who would be refused a benefit because they had subsequently sold the shares.

More compliance headaches would be added to companies already battling to contain costs if they are forced to distinguish between classes of shares to avoid this possible inequity. Additional compliance obligations may cause the Australian industry to regret ever asking for special consideration.

The cap on the budgetary impact also raises doubts about the size of any benefit to individual investors. The government proposes to ration the amount of exploration credit made available if claims exceed the maximum approved under the programme in any year. Investors could have to wait a year or more before knowing the size of the benefits they are to receive in exchange for their investment.

An effective incentive scheme should change behaviour and not simply reward actions that were going to occur in any event. With so much uncertainty attaching to the eventual tax benefit from this initiative, it is hard to see how investors can take account of the new measure in their decision-making.

This offering to the mining industry accompanied another budget initiative to set up a A$20 billion fund from hypothecated medical service charges to support medical research in Australia. In promoting the idea, ministers rightly gushed with pride over the accomplishments of the nation's researchers.

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Australians are at the leading edge of endeavours in both fields making for an invidious choice between the two. The absence of any meaningful analysis on which activity contributes the greater economic and social benefits retards the capacity of policymakers to make an informed choice. Nor do we understand which activities are more sensitive to changes in government funding.

The policies outlined in the budget said plenty about how the government feels about the respective contributions of the nation's explorers and researchers. Put bluntly, the well-connected city-based men and women in white coats appeared far higher in the pecking order than those folk poking around rocks. Perhaps, in the end, the choice is about image as much as anything else. ▼

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