SUBMISSION TO THE REVIEW OF BUSINESS TAXATION

AUSTRALIAN GOLD COUNCIL

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1. The Australian Gold Council

1.1 Background of the Australian Gold Council

The Australian Gold Council was formed in October 1998 to represent the interests of Australian gold industry and combines the view of producers, explorers and prospectors.

The Australian Gold Council is an organisation in its infancy but has more than 70 members representing 90 per cent of the ounces produced in Australia.

The Australian Gold Council's mission is to promote and improve the profile of the Australian gold industry at home and abroad. It will also highlight the gold industry's social, economic and regional importance to Australia and seek to improve capital access and enhance the investment climate for the industry.

Australian Gold Council members have identified the following issues to be tackled by the organisation:

- To raise and improve the profile of the Australian gold industry at home and abroad;
- To facilitate industry research, information exchange and general publications relating to the economic and social contribution of the gold industry to Australia;
- Address gold specific taxation issues including royalties and tariffs, and financial reporting and regulation guidelines;
- Improve capital access and address issues to encourage investment in gold exploration;
- Build links to government and opinion leaders and facilitate and improve industry networking

The Australian Gold Council intends to be responsive and driven by its member's needs. A key priority is to build public, government, and investor understanding of the industry's role and potential.

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1.2 The Australian Gold Industry

The Australian gold industry makes an important contribution to the Australian economy as an export earner, regional infrastructure provider, employment generator , and wealth creator.

The Australian gold industry is the:

- Largest manufactured exporter in Australia;
- Second largest outright exporter in Australia;
- Contributed $7,426m in annual exports in the 1997-98 financial year with forecasts of $6,622m in the current fiscal year;
- Spent $648 million on private mineral exploration expenditure in the 1997-98 financial year;
- Produces 10.2 million ounces a year;
- Is relied upon by more than 100 regional centres;
- Employs 15,000 direct jobs and 45,000 indirectly.

The Australian gold industry is a world leader. It is at the forefront in financial risk management and technology and is one of the most efficient users of capital.

1.3 Industry Challenges

The Australian gold industry and the world minerals producers face a commodity and equities market environment not seen since the 1987 share market crash. Many sectors with the mining industry face commodity prices at 20 and 30 year lows. With access to new capital constrained, severe price pressure, the minerals sector faces steep challenges.

In Australia issues of land access and the regulatory environment is also posing difficulties for explorers and emerging producers to help find and create the next generation of mines to continue to drive the Australia's gold industry forward.

1.4 Jobs Growth

The gold industry provides significant employment opportunities. However, future job growth and employment opportunities in the gold industry will be largely influenced by the following:-

The level of expenditure incurred on gold exploration in the short term; and
The level of capital investment in gold mining projects over the long term.

Exploration is the lifeblood of the industry. Job growth in the gold industry is dependent on the level of exploration spending. Exploration expenditure fell substantially in 1997-98 by 11% to $648m and is expected to fall further in the next two years. With this fall, and the likely adverse financial impact of a number of proposed reform measures, the AGC has grave concerns regarding the long term trend of gold exploration expenditure in Australia.

2. Summary

2.1 Overview

The Australian Gold Council ("AGC") supports the urgent need for business tax reform in Australia, and the **overriding objectives** of a redesigned business tax system as outlined by the *Review of Business Taxation* ("*the Review*"):

- to improve the climate for investment and productivity; and
- to boost employment and the standard of living for Australians - by creating a more competitive business environment.

The AGC considers that the overriding objectives of tax reform are achievable within a framework of a revenue neutral trade-off to achieve a 30% corporate tax rate. However, it is only fair that the burden of tax reform is shared equally across industry sectors. Under the proposed reform options being considered by the *Review*, the mining sector and the gold sector specifically will receive more than a fair share of the burden.

The AGC Submission has been prepared to highlight that the burden would be shared unequally under the reform options. The Submission also provides specific details of the adverse effects that the reform options will have on the gold industry. The AGC is open minded on the issues of tax reform and how best to achieve a reduced corporate tax rate of 30%. However, the AGC believe that the reform options must produce an equitable outcome with the burden of reform options being shared between industries on an equitable basis.

Two examples of proposed reform options that will significantly impact the gold industry are discussed below.

Of the proposed changes the most significant for the gold industry is the options on expenditure associated with overburden removal. Under the proposed changes the gold industry would be at a significant disadvantage as an immediate deduction would not be available for overburden expenditure and the ore would be capitalised with the deduction spread over the mine life. Alternatively, the overburden would be treated as trading stock. Presently, gold mines are feasible even though they have a higher strip ratio than other mining industries. A higher stripping ratio (the proportion of overburden that has to be remover per unit of ore) can be maintained by gold miners when compared to other mining industries, due to the higher value of the ore by volume. However, if the proposed changes were implemented a number of new gold mines would no longer be economically viable.

Another significant reform option is the Deferred Company Tax measures. These measures are expected to significantly impact on the gold industry's ability to attract and retain investment capital, especially from overseas institutional investors. The gold sector relies heavily on foreign institutional investment from Europe and North America, and the AGC notes that the DCT measures will adversely affect these investors. Without access to significant investment capital provided by European and North American institutional investors, spending on gold exploration and mining operations may sharply decline below current levels particularly in the exploration and junior company ranks. Capital spending is the key to achieving the overriding objectives of tax reform such as boosting employment, especially in the regional areas of Australia.

These two examples alone highlight that significant tax reform options raised by the *Review* must be considered in further detail prior to finalising recommendations to Government.

The AGC considers that the relentless pursuit of a lower corporate tax rate, in the context of a revenue neutral trade-off, is likely to fail in achieving the overriding objectives of business tax reform. This is due to a number of significant reform options that, if implemented, will adversely impact on future investment in key Australian industries. As discussed above, what is required is an equitable approach to tax reform that will not adversely impact investment spending and key export markets. It is also apparent that the main beneficiaries of the reform options will be industries that are service providers who are not required to invest significant resources in capital items such as plant and equipment. It is the service industries, for example the banking sector, who will be winners should a 30% corporate tax rate be introduced. The revenue neutral trade-off measures in their current form are biased against capital intensive industries. However, industries such as the banking industry are unlikely to boost employment (a key objective of tax reform) under the reform options. The banking industry has in fact shed tens of thousands of jobs in recent years. The AGC would argue that it is the capital intensive industries such as gold mining that contribute to employment growth, especially in regional areas of Australia whose future viability is linked to investment.

The AGC also notes that the expected winners of the tax reform process, finance and business service companies, had an effective tax rate of 9.21% for the 1996-97 year, when compared with mining companies who had an **effective tax rate of 24%** [source Taxation Statistics 1996-97]. Given this, achieving equity under the tax reform options becomes more critical. Under the proposed measures, the gap between mining and services industries is likely to further widen with the mining industry shouldering an even higher proportion of the tax burden. The AGC consider this to be unacceptable.

2.2 Significant Reform Options

There are a number of significant reform options that the AGC considers will be detrimental to the Australian economy. These are discussed below.

2.2.1 Taxation of Financial Arrangements (“TOFA”)

A separate joint submission to the Review has been prepared by the Minerals Council of Australia (“the Council”) and AGC on TOFA .

2.2.2 Overburden Removal

The AGC strongly opposes changing the current provisions which provide for the outright deductibility of costs associated with overburden removal. In considering the reform options it is clear that the gold industry is likely to be significantly disadvantaged when compared with other industries, for example the coal industry. This is due to the higher strip ratios of most gold mines (sustainable due to the higher economic value by volume of the ore). The loss of the immediate deductibility of the high initial overburden rates will have a dramatic effect on the economics of new projects.

2.2.3 Deferred Company Tax ("DCT")

The proposed DCT measures are rejected by the AGC. These measures are considered inequitable as they are likely to result in a double taxing of profits in a number of circumstances. Another concern is the impact of these measures on non-resident institutional investors who are significant investors in the Australian mining industry, in particular the gold industry. The DCT will raise the effective withholding tax rate (it will at least double) on unfranked dividends paid to non-residents. Whilst this may seem relatively insignificant, the AGC predict that a fall in dividend yields will see non-resident investors seek alternative higher returns in other taxing jurisdictions. It is difficult to quantify the potential impact on the economy. However, the AGC envisage that the impact, when considered in terms of a decline in investment, will be significant.

2.2.4 Taxation of Entity Distributions - Other Options

The AGC rejects the other reform options due to the potential double taxing of profits.

2.2.5 Accelerated Depreciation

The AGC considers that the retention of the current accelerated depreciation measures is critical to ensure that an equitable business tax system remains in operation. Presently, the high capital costs associated in investing in key export industries such as gold mining is recognised. However, under the proposed measures capital intensive industries are clear losers and the proposed reduction in corporate tax rates is not seen as an equitable trade-off by the AGC. Service industries are the clear winners under a reduced corporate tax rate. However, it is unlikely that the overall economic benefits of a reduced corporate tax rate will outweigh the costs of the proposed measures, and their potential adverse impact on investment, employment and exports.

Either of the *Review* options will result in many current and potential gold projects being economically unviable.

2.2.6 Tax Reform and the Gold Industry

The AGC considers that there is a need to consider the economic impact of the tax reform options on an industry by industry basis. This is critical if the overriding objectives of a redesigned business tax system are to be achieved.

2.2.7 'Blackhole' Expenditure

The AGC strongly supports the need for changes to the current taxation treatment of 'blackhole' expenditures. It is important to recognise that the 'blackhole' expenditures described by the *Review* are recurrent and regular outgoings of gold mining entities, for example costs associated with feasibility studies and native title claims. Their treatment as outright deductible is seen as a necessary step to clearing up a 'grey area' for tax purposes and ensuring that these expenditures are treated consistently by all taxpayers.

2.2.8 Overseas Expenditure

There are a number of issues that the AGC believes should be considered as part of the business tax reform process. Broadly, the AGC considers that the 'quarantining' of deductions that relate to overseas expenditure incurred by gold companies is acting as a restraint against investment spending. For example, the AGC considers that if the rules allowed for overseas gold exploration and mining costs as an immediate deduction against Australian income, investment spending would be likely to increase. Ultimately, in the longer term this is likely to mean increased tax revenues for the Government as more and more projects move from the exploration to the mining stages.

2.2.9 Removal of Balancing Charge Offset

This is not seen as a significant issue in terms of achieving a reduced corporate tax rate via a revenue neutral trade-off. Accordingly, the AGC does not consider that there is any need for changing the current measures which are considered a necessary stimulus to promote investment in capital expenditure.

2.2.10 Excess Deductions

The AGC considers that the rules that relate to excess mining deductions are not being exploited. If this was the case, then the wide sweeping anti-avoidance provisions (Part IV A) under the Income Tax Assessment Act would have been applied by the Commissioner of Taxation. Any changes to these rules are opposed and it is recommended that the anti-avoidance provisions are applied in circumstances where exploitation occurs.

2.2.11 Consolidation of Entity Groups

The AGC reject the consolidation options as the proposed changes will not simplify the current system, in fact the consolidation system appears to be more complex and onerous on taxpayers. There is also a concern that the 'optional' system is unfair as if an entity chooses not to consolidate then they cannot take advantage of the current grouping provisions (eg transfer of tax losses).

There is also the issue of tax losses remaining in the group when the entity incurring the loss is disposed, and the impact of rebatable dividends on tax losses. The current system is working and provides for flexibility in the restructuring of company groups. The AGC considers that there is no reasonable argument for changing to a consolidation method.

2.2.12 Loss Carry Back

The AGC believe that the introduction of a limited form of loss carry back mechanism should be considered as part of the tax reform process. This would enable certain deductions to be correctly matched against revenues derived from gold projects. For example, mine closure costs can be significant and matching these costs against revenues derived over the mine life is seen as providing a more equitable outcome.

2.2.13 Exploration & Prospecting Expenditure

The AGC supports the retention of an outright deduction for expenditure incurred on exploration activities. Mineral exploration must be supported to ensure that new mineral deposits are identified to replace existing mineral reserves.

2.2.14 Research and Development Expenditure

The AGC supports the need for R&D measures. These measures provide a necessary stimulus for investment in the pursuit of new technology that can improve business efficiency. To remain internationally competitive, it is important that these measures are retained in their current form.

3. Taxation of Financial Arrangements ("TOFA")

The AGC and the MCA have prepared a separate joint submission to the *Review* on TOFA.

4. Overburden Removal

4.1 Current Position

Costs associated with removing overburden to expose the ore body is currently treated as a revenue cost being part of the method of extraction of mineral deposits and is deductible as and when incurred. These costs represent a significant up front expenditure for new gold projects.

4.2 Review Options

The *Review* options consist of either capitalising overburden costs and depreciating the costs over the life of the relevant ore body, or valuing and absorbing the cost into the relevant mineralised ore as it becomes trading stock.

4.3 Submission

The current taxation treatment of overburden removal should be maintained. The *Review* options will have significant adverse financial consequences on the mining industry, with the gold industry being the major loser under the proposed changes. This is due to the economic impact on the gold industry when compared to other mining industries such as coal mining. This is discussed below.

Open cut mining is common for gold mining operations. The open cut method requires the removal of significant overburden during the various phases of the mine's life. Initially, this results in high stripping ratios. However, a higher stripping ratio (the proportion of overburden that has to be remover per unit of ore) can be maintained by gold miners when compared to other mining industries, due to the higher value of the ore by volume. However, under the proposed changes the gold industry would be at a significant disadvantage as an immediate deduction would not be available and the ore would be capitalised with the deduction spread over the mine life. Alternatively, the overburden would be treated as trading stock. It would no longer be economically feasible for a number of new mines to be developed under the proposed changes due to the timing effect of the deduction.

Also, the AGC anticipate that the time deferral in question is not substantial from the government revenue perspective. The accounting treatment for waste overburden allows it to be spread over the first few years of a mine's life and of course the mineral producers' objective will be to extract ore as soon as possible to maximise positive cashflow and obtain the earliest payback for the project that is possible.

The AGC maintain that the current and correct treatment for expenditure incurred on overburden removal is immediate deductibility as and when incurred.
A change of treatment of overburden from revenue to capital would endanger the viability of a number of new potential gold projects at a time when the industry is under severe pressure from amongst other things, low commodity prices.

The non-immediate deductibility of overburden may push a number of projects out of development and is likely to have a dramatic effect on the state of the gold industry, the amount of gold exported and the government revenue generated from this sector.

5. Deferred Company Tax ("DCT")

5.1 Review Options

The DCT proposal will require companies paying dividends to pay a new additional tax to top-up and make partially franked dividends fully franked. This is a critical change put forward by the *Review* as it affects all other areas of the tax reform proposals.

These measures will adversely impact the gold industry, the nation's largest manufactured exporter. The AGC considers the DCT measures as a critical reform issue, which should be rejected.

5.2 Submission

5.2.1 Reasons for Rejecting DCT

- DCT could be the final disincentive that prompts Australian companies to move their headquarters offshore because the tax would not apply to international companies operating in Australia.

- The DCT goes against international trends, such as the UK which last year scrapped the Advanced Corporations Tax. Similar deferred company tax proposals have been debated in other parts of the world but ultimately dropped as illogical and disadvantageous to the country's domestic or resident companies.

- The DCT proposal is a disincentive to pay out dividends. Dividends are a major reason international investors invest in the Australian gold sector which differentiates Australian gold companies from their overseas competitors and rivals.

- Australian multi-nationals that have significant opportunities to expand in Australia will be double taxed as profits from their offshore operations which were fully taxed overseas may be taxed again upon distribution to shareholders in Australia.

- Non-resident shareholders who are currently subject to 15% withholding tax on unfranked dividends will suffer an increase in withholding tax of more than double – with no guarantee of refund in their home country for the difference. DCT therefore penalises foreign investors who invest in Australian companies.

- The DCT will reduce bottom line profit, undermine earnings per share and consequently reduce dividend payouts. Share prices of Australian companies are likely to fall making them more vulnerable to takeover if they remain in Australia. They may be forced to move offshore.

- The DCT cannot be refunded against corporate tax. This inability to offset DCT against corporate tax will affect corporates with large timing differences as a result of the cyclical nature of their business and the distinct phases of mining. For example, a gold mining company in tax losses in the early years of development would pay DCT on their dividends and then have to pay corporate tax on top in later years when the project is in the production phase and making profits.

- Imposing a DCT would increase the effective tax rate for industries such as mining and penalise them for not paying fully franked dividends, due to the timing of tax receipts during the start up phase of new projects.

- The government talks about globalisation, an open economy and establishing regional headquarters for investment, but the DCT measures will defeat these objectives. It sends a clear message that Australian based companies should not grow through offshore acquisition and should reward local shareholders at the expense of offshore shareholders. Under the DCT, Australia will become isolated, with companies discouraged from buying offshore and offshore companies choosing not to invest here.

- Overseas investors such as European and North American institutional investors are significant investors in the Australian gold industry. In contrast, Australian superannuation funds and institutional investors which hold significant share investments, are not the major investors in the Australian gold industry. Recently, superannuation funds have tended to pursue an investment allocation that is weighted towards investment in the media, financial services and telecommunications sectors. This tends to be the result of market band index weighting for portfolio performance. Due to the Government privatisation process and the increased trend of investing in the financial services, telecommunications and media sectors, the percentage of the Australian capital market that the Australian gold sector represents has been greatly reduced from 13.3% of the All Ords. index in November 1987 to 7.36% of the All Ords. index in July 1993 and is now currently 1.39% of the All Ords. index. The AGC notes that there is no compulsion for Australian superannuation and institutional investors to support investment in the Australian mining sector. In contrast, Canadian laws require certain pension funds to hold at least 80% of their investments in Canadian assets, thus supporting local investment in the resources sector. Accordingly, the potential loss of non-resident investors and capital providers due to the impact of a DCT will make it difficult for future investment in the gold industry to be sustained.

5.2.2 Reasons for Retaining the Current System

The rationale for reform of entity taxation apart from aiming to reduce complexity was to minimise the potential for taxpayers to stream franked and unfranked dividends. In reality, few taxpayers would undertake dividend streaming as most are discouraged by the anti-avoidance rules relating to such arrangements. If there is a perceived problem with the streaming of dividends, the AGC supports the application of the anti-avoidance provisions.

It is doubtful that the proposed DCT system is any less complex, it has been shown internationally to disadvantage resident companies and to have a considerable economic impact. With the current system of entity taxation not overly complicated and working well the change to the DCT regime is not a compelling one.

6. Taxation of Entity Distributions - Other Options

6.1 Review Options

In addition to the DCT option which is rejected by the AGC, the *Review* has considered two other options for the taxation treatment of entity distributions. The options are:

Option 2

- Apply a Resident Dividend Withholding Tax ("RDWT"). This would work like DCT for resident shareholders, but would differ in important respects:

    1. Reported after-tax company profits would not be reduced, except for entities in receipt of unfranked distributions.

    2. It would be necessary to keep track of franked/unfranked dividends and complex anti-streaming rules would still be required.

- This option would achieve some of the Government's policy objectives, but not all of them. In particular, perceived revenue risk associated with dividend streaming would remain.

- RDWT would eliminate the significant DCT problems in respect of non-resident shareholders.

- The AGC consider that this option would not overcome the significant concerns that gold companies have with DCT.

    ◊ The benefit of tax-preferred income (such as income benefiting from accelerated depreciation) would be eliminated at the point of distribution to a domestic investor. This loss of benefit would be permanent as there is no ability to offset future corporate tax against the RDWT. This would result in double taxation.

    ◊ The inability to offset RDWT against future corporate tax severely disadvantages the mining industry in particular over other industries which could result in double taxation on their profits. The mining industry has large timing tax differences which arise from the cyclical nature of their business and their distinct phases of mining.

Option 3:

- Taxing unfranked inter-entity distributions.

- The AGC considers that this option would eliminate DCT problems in respect of non-resident shareholders and resident individual shareholders.

- Reported after-tax company profits would not be reduced, however entities receiving unfranked distributions would have a higher tax liability.

- The benefit of tax-preferred income (such as income benefiting from accelerated depreciation) would be eliminated at the point of distribution to a domestic entity. This loss of benefit would be permanent as there is not ability to offset future corporate tax against this tax. **This would result in double taxation**.

- The inability to offset this tax against future corporate tax severely disadvantages the gold industry in particular over other industries.

- It would be necessary to keep track of franked/unfranked dividends and complex anti-streaming rules would still be required.

- This option may only achieve part of one of the Government's three policy objectives; that is, it would eliminate scope for manipulation of the inter-corporate dividend rebate.

- The most significant disadvantage of this option, when compared to the RDWT, is that there is no mechanism proposed to refund the tax payable on the dividends where these are on-paid to non-resident shareholders. The RDWT does contain such a mechanism.

Given the above problems identified, the AGC considers that there is no compelling reason for change from the current system. The double taxing of profits is a significant concern to the AGC.

7. Accelerated Depreciation

7.1 Overview

For many Australian gold producers the current ability to depreciate mineral assets over the lesser of the estimated mine life or 10 years does not represent a significant benefit. Indeed the initial mining life as determined by proven reserves and used as the basis of the project life for the majority of Australian gold projects is usually less than 10 years.

Continued investment in exploration in and around existing projects often leads to increased gold reserves and lengthens the eventual life of a mining project. However this is far from certain and it may be several years of a project's existence before the mine life is extended in this fashion.

Further and more detailed financial modeling would be required in order to ascertain the relative effect of the trade-off between a lower corporate rate of tax and a loss of the 10 year depreciation cap.

There are a number of other concerns that arise from the discussion of the treatment of wasting assets that should be addressed.

These include:

- A possible change of the start date of the treatment of wasting mining assets (not plant or equipment) from the time of investment to the time when investment becomes income producing. Currently if the asset becomes income producing on the last day of the year then a whole year deduction may be made for expenditure on mining, quarrying and mineral transport.

- The detailed mechanisms as to how effective life may be determined. If a schedule or broadband approach is used then past experience shows that taxpayers will tend to rely on this. However, standard depreciation schedules tend to go out of date quickly.

The AGC are also concerned about the underlying assumptions regarding the value of removing accelerated depreciation on revenue. The *Review* forecasts increased revenue of $2.4 billion in 2003/4 from the abolition of accelerated depreciation revenue – the major contributor to offset a fall of $3.1 billion from the reduction in the rate of corporate tax and other tax changes.

While the *Review* recognises that no allowance is made for a change in investment behaviour due to the lowering of the tax rate and the change to depreciation, it is likely that such change would be dramatic. Whilst such modeling would be inherently difficult, this is surely a critical issue that must be addressed over a longer time horizon. The fall off of long term capital investment and subsequent tax revenue from income generated by such investment should be modelled on an industry by industry basis.

7.2 Submission - Reasons for Rejecting Removal of Accelerated Tax Write-Offs

The AGC supports the retention of accelerated depreciation for the following reasons:

- Abolishing the accelerated tax write-offs of wasting assets such as plant, equipment, exploration expenditure, overburden removal, prepaid stripping and research and development activities raises the cost of these integral assets and activities, reduces cash flow and would make many projects less attractive or unviable.

- Removing accelerated tax write-offs will remove the incentive to invest in new or existing operations, and ultimately to generate wealth and create jobs. Therefore, the first step the Government should take in the business tax reform debate is to remove the focus of revenue neutral proposals. Designing an equitable system should be the main focus.

- There is a belief that lowering the corporate tax rate will attract foreign investment. This is simply not true. The Economic Intelligence Unit index of business-friendly countries for 1999 – 2003 puts high-taxing Netherlands at the top of 60 countries. Of the 12 countries ahead of Australia, only Hong Kong had a lower tax burden than Australia. Rather than looking at the nominal rate, foreign investors are more interested in the effective tax rate which includes the impact of tax write-offs.

- The accelerated tax write offs reflect the fact that long lead times are involved in mining before generating sales revenue per dollar of investment which is very low relative to most industries. As the mining industry has a different risk-reward profile than most, the proposed changes, which could halve the tax benefit to the industry, will mean that new projects which would have gained 'a green light' will not go ahead.

- The debate should be about which balance gives the best overall result for the nation. The mining and minerals processing industry is an important part of the Australian economy which is responsible for $36 billion of GDP, 450,000 jobs in Australia, 20% of business investments, 46% of merchandise exports, and $12 billion a year spent on Australian goods and services. Whilst new industries should be encouraged, existing industries representing the largest part of the economy should not be prejudiced in the tax reform process. What is important as part of the tax reform process is to look after the existing industries that are supporting the economy.

- Coming on top of the uncertainty surrounding native title, a removal of accelerated tax write-offs will jeopardise the early phases of exploration and development and will prove a disincentive to investment in new Australian ventures in preference to mature Australian operations or new offshore projects.

- The mining industry will be forced to finance a 6% reduction in income tax (from a corporate tax rate of 36% to 30%) for other industries which do not have the same commitment to investment in regional Australia or the economic multiplier in generating wealth and sustaining exports.

- **The economic impact of the *Review* options on regional Australia will be significant**.

8. Tax Reform and the Gold Industry

8.1 Objectives of Tax Reform

A *Platform for Consultation* canvasses a range of options for business taxation reform. It is expected that a reformed business taxation system will deliver the following socially optimal outcomes:

- achieve internationally competitive as well as economically efficient business tax arrangements;
- deliver job growth and productivity performance over the long term;
- achieve better economic performance,
- stimulate investment and innovation; and
- achieve a better functioning capital market.

The AGC agrees that there is an urgent need for business tax reform in Australia. Achieving a simplified and equitable tax system in addition to the expected social and economic benefits of tax reform is considered to be highly desirable. However, the AGC believes that the impact of the *Review* reform options should be considered on an industry by industry basis. For example, the impact of the reform options will differ widely between service industries and capital intensive industries, such as gold mining. The argument for a trade-off between industry specific deductions and a lower corporate tax rate must be carefully considered. This is discussed in further detail below.

8.2 A Need to Consider Reform Options on an Industry Basis

8.2.1 Overview

Historically, capital intensive industries such as the gold industry have relied on industry specific deductions in some form. These industry specific deductions were initially introduced to support the financial viability of investments (eg gold projects) which required significant start up capital if they were to be successful. With the benefit of hindsight many projects would not have progressed beyond the feasibility study phase without these industry specific deductions.

The AGC supports the retention of key industry specific deductions to ensure the gold industry's long term viability. This is on the basis that the gold industry is a significant contributor to the Australian economy (eg investment, exports and employment) and this ongoing contribution can only be maintained if the industry remains internationally competitive and continues to invest significant resources in exploration and new gold projects.

There is a strong case that the impact of reform options must be considered on an industry by industry basis, especially when considering key industries such as the gold industry which is a significant contributor to the Australian economy. The need to consider the impact of reform options on an industry basis is discussed below.

8.2.2 Summary of Key Economic Data

The Australian gold industry is important to the Australian economy:

- largest manufactured exporter in Australia;
- second largest exporter in Australia;
- the gold sector contributed $7,426m in annual exports in the 1997-98 financial year with forecasts of $6,622m in the current fiscal year;
- private mineral exploration expenditure for the gold industry accounted for $648m in the 1997-98 financial year. Investment in gold exploration provides significant ‘spin-off’ benefits to the economy;
- refined Australian gold production for the 1997-98 financial year accounted for 275.9 tonnes; and
- Australian gold exports accounted for 359.1 tonnes for the 1997-98 financial year.

8.2.3 International Competitiveness

Investment in gold projects requires a long term commitment and access to significant investment capital. For these reasons, to attract the necessary capital the forecast after tax rate of return must be higher than other investments. However, a positive after tax rate of return on any gold investment is largely dependent on a number of variables which include:

- gold prices;
- supply and demand issues;
- foreign exchange and hedging strategies;
- cash costs of production;
- source of financing (debt/equity) and the required rate of return on investment; and
- taxation incentives (eg deduction for overburden removal).

In terms of the above the Australian gold industry is a world leader :

- it is one of the most efficient users of capital (ie capital costs are significantly lower in Australia),
- is at the forefront in financial risk management and technology; and
- operations are efficient when compared to other countries.

However, even though the Australian gold industry is a world leader in many respects, the importance of industry specific deductions to attract investment cannot be underestimated. The AGC considers that industry specific deductions are **critical** to the international competitiveness of the Australian gold industry. This is discussed below.

To attract much needed investment capital and short term funding, the gold industry must be seen to be internationally competitive. This is often measured in terms of after tax rates of return. This view is supported by a report issued in 1997 by the Institute for Global Resources Policy and Management (Colorado School of Mines). The report, titled *"Global Mining Taxation Comparative Study"*, provides important information regarding the link between industry specific deductions and gold investment. The following observations are provided at pages 5 and 6.

> *"Minerals production involves the transformation of non renewable physical assets into reproducible capital or financial assets. The initial decision to invest, and the resulting allocation of revenues and benefits, are greatly influenced by the content of existing taxation policies. Therefore, the design of a minerals taxation regime, whether by statute or negotiations, must be approached carefully and objectively."*

The AGC agrees with these observations, in particular the need to approach business tax reform carefully and objectively.

The report provides a comprehensive analysis (based on a mine model which assumes certain basic attributes) of the comparative after tax rates of return on gold investment around the world. Notably, of the significant geographical segments compared, Western Australia ranks 18th out of the 23 taxing jurisdictions which formed part of the study.

This is obviously a disappointing result and the AGC is very concerned about the impact of certain business tax reform options on the gold industry's ability to be seen to be internationally competitive. For example, if proposed changes to the taxation treatment of overburden removal and wasting assets are legislated, after tax rates of return are likely to further fall. Another AGC concern is the impact of the DCT. The proposed DCT measures will see reported after tax profits fall, reduced cash distributions to shareholders, and falling dividend yields. These reform options alone will significantly impact the level of investment in Australian gold projects as investors seek higher after tax rates of returns in more favourable taxing jurisdictions. The AGC considers that a 'level playing field' is required if Australian gold projects are to be considered internationally competitive by the global investment community.

8.2.4 Job Growth

The gold industry provides significant employment opportunities. However, future job growth and employment opportunities in the gold industry will be largely influenced by the following:

- the level of expenditure incurred on gold exploration in the short term; and
- the level of capital investment in gold mining projects over the long term.

Job growth in the gold industry is dependent on the level of expenditure incurred on gold exploration in the short term because exploration is required to identify financially viable long term mining projects, the key to job growth.

The AGC notes however that gold exploration expenditure fell substantially in 1997-98 by 11% to $648m. This fall in expenditure is contrary to the experience of the early 1990's in Australia where real expenditure on gold exploration more than doubled over the six years to 1996-97. Given this fall, and the likely adverse financial impact of a number of reform measures, the AGC has grave concerns regarding the long term trend of gold exploration expenditure in Australia. A significant decrease in the level of exploration expenditure will adversely impact job growth and employment levels in the gold industry (for the reasons described above). Clearly, this outcome is not consistent with the expected overriding objectives of business tax reform.

8.2.5 Stimulate Investment and Innovation

The *Review* options will impact the level of investment in the gold industry more severely than other industries. The reasons for this have been articulated above and include the fall in after tax rates of return and uncertainty surrounding the financial viability of border line gold projects. For these reasons, industry differentiation is integral in achieving equity in the tax reform process.

9. ‘Blackhole’ Expenditures

9.1 Introduction

The AGC endorse many aspects of the issues recognised by the *Review*. In particular, the current inconsistencies in the tax treatment of so called ‘blackhole’ expenditures, which are common outgoings necessarily incurred in the course of gold exploration and mining projects.

9.2 Submission

9.2.1 Feasibility Study Costs

Currently, feasibility study costs associated with the viability of extracting minerals are, along with other exploration expenses, deductible when incurred. The AGC believes that this should be the general case for **all** feasibility or market studies. With the overall objectives of economic growth and job growth in mind it is sensible to encourage investment by allowing preliminary expenses to a business or project as deductible. This should be the case regardless of the success or otherwise of a project’s feasibility.

9.2.2 Write-Off of Cost of Mining Tenements

The *Review* states that all ‘wasting’ assets should be written off over their useful life and lists the following ‘blackholes’ as items which may enjoy a tax write off in the future:

- mine closure costs; and

- native title defence costs

Furthermore, the *Review* discusses the option of allowing a tax write-off for goodwill. This is welcomed by the AGC but there is no mention of one of the mining industry’s **largest** ‘blackhole’ – expenditures incurred on acquiring exploration and mining tenements.

Currently there is no tax write-off allowed for expenditure incurred on purchasing a mining tenement. This does not reflect the true nature of a mining tenement which is a wasting asset in its purest form. The value of a mining tenement decreases in proportion to the depletion in mineral reserves. On this basis, a tax write-off on an amortisation basis should be allowed. Furthermore, a write-off would remove the severe disadvantage Australian companies have with overseas competitors (ie US) that allow a write-off for purchased goodwill and mining tenements.

9.2.3 Other 'Blackhole' Expenditures

Listed in the below table is a summary of a range of ‘blackhole’ expenditures that the AGC considers should be deductible for tax purposes, either as an immediate write-off or on an amortisation basis in appropriate circumstances.

Exploration and evaluation

Costs of acquiring mining lands, leases and mineral rights from former owners of mining interests
Equity capital raising costs (including prospectus and underwriting costs)
Goodwill and premiums in relation to acquisition
Payments to defend native title land/assets
Pre exploration costs
Compensation to landholders for rights to use/enter property
Costs of certain feasibility studies on aborted downstream projects
Payment by lessee to cancel an onerous lease
Work “outside boundaries” - work on land owned by other parties (usually local government) on condition of planning approval being granted

Pre-incorporation phase

Pre-incorporation costs
Legal and consulting costs to establish a business.

Development and operation

Contributions to regional infrastructure (roads, community facilities, ports, housing and welfare)
Further payments to defend native title land / assets
Certain rehabilitation costs (for example, beautification costs during operations)
Demolition costs
Costs associated with the removal and relocation of business operations
Payments to dispose of a liability (payment to settle a dispute over a capital contract)
Payment by lessee to cancel an onerous lease
Settlement payments to conclude unfavourable legal cases / contracts
Legal and compensation costs in defending / preserving business practices
Payment of compensation and rectification costs paid from past acts of subsidiaries
Payment under a letter of guarantee in support of the act of a subsidiary
Takeover defence costs

Closure

Demolition costs
Mine closure costs (ability to carry back deductions)
Carry back of losses
Capital expenditure write-off limits

10. Overseas Expenditure

10.1 Submission

10.1.1 Limitation on Deductibility of Interest

There is a proposal to prevent a deduction for interest on monies borrowed where the Australian operations are overgeared relative to the overseas operations. Under this proposal, the cost of expanding offshore would increase.

- Australian multinational companies are already at a severe disadvantage to overseas competitors as they cannot claim an interest deduction on monies borrowed to fund an overseas expansion. Forcing companies to allocate a further arbitrary amount of interest to overseas investments would put them at an even greater disadvantage to overseas competitors who are not subject to such restrictions.

- Borrowings may be directed towards Australian investments rather than offshore investments for commercial reasons, such as banking restrictions, guarantee requirements and the risk level of the overseas investment relative to Australia. Companies that are already subject to these restrictions on their borrowings would be further penalised by a tax system that forces arbitrary allocation of interest without reflecting commercial realities.

- This limitation on interest based on an entity's borrowing ratio of Australian assets to overseas assets will severely disadvantage Australian multinationals attempting to expand overseas and sends a clear message that Australian based companies should not grow through offshore acquisition. This will prompt Australian multi-nationals to move their headquarters overseas.

10.2.2 Overseas Exploration Expenditure

Australian gold companies who invest in overseas exploration projects are subject to the quarantining rules. Under these rules overseas expenditure, including exploration expenditure, is quarantined until foreign source income is derived and the deductions can be utilised against the foreign income.

This issue has not been considered by the *Review*. However, the AGC considers that these rules act as a significant impediment for Australian gold companies, especially those who are increasingly relying on investing in overseas gold projects for growth. A simple example of the affect of these rules is where a gold company derives Australian source income from an existing mining project, and at the same time incurs foreign exploration expenditure. In the short term cash flows are affected as the overseas deductions cannot be utilised.

The AGC considers that overseas mining and exploration deductions should be allowed as an immediate deduction against Australian source income derived from mining projects. This would act as a significant incentive for mining investment both in Australia and overseas.

There are obvious associated economic benefits if investment is stimulated. The AGC consider that this measure may result in increased Government revenues over the long term if Australian gold companies can utilise overseas exploration deductions in Australia. This is on the basis that increased investment in Australian gold projects will result in increased revenues from the taxing of gold sales. This is also the case for investments in overseas gold projects where the income from the projects will be ultimately assessed in Australia under either the normal income rules, or the controlled foreign company rules where the overseas entity is controlled by Australian resident shareholders.

On a final point there are other benefits in supporting overseas exploration investment, such as the economic benefits derived from exporting technology and know-how. The Australian gold industry is a leader in these areas and exports may grow in future years if the necessary stimulus is provided.

11. Removal of Balancing Charge Offset

11.1 Current Position

Balancing charge offsets enable taxpayers to set otherwise assessable balancing charges arising on the disposal of assets against the cost of replacement assets, the cost of other new assets, or the depreciated tax written down value of other assets. The offset facilitates the acquisition of replacement equipment by taxpayers. It is a particularly important support mechanism for taxpayers operating in capital intensive industries (such as gold mining) where an assessable balancing charge is an immediate cash outflow which must be considered prior to investing in plant and equipment.

11.2 Review Option

The *Review* proposes that the removal of the offset would produce revenue gains to fund alternative measures such as reductions in the corporate tax rate. Such a trade-off would be at the expense of taxpayers who currently derive significant benefits from the offset but would benefit other taxpayers.

Removal of the balancing charge offset provisions would result in the cost of an asset being fully deducted over the effective life of the asset.

11.3 Submission

The balancing charge offset provides considerable benefits due to a deferral of an otherwise assessable balancing charge. Should the taxpayer be denied the ability to offset such balancing charges, the government would raise an estimated $80 million of revenue gains which would help fund the proposed 30% corporate tax rate.

The AGC rejects the removal of this measure as it could result in adverse consequences for the gold industry. For example, it is likely that future capital investment decisions will be affected as gold companies may be more reluctant to invest in significant capital assets as it would no longer be possible to defer balancing charges by deducting them from replacement assets. Rather, amounts would be assessable. This is likely to have significant cash flow implications for capital intensive industries, resulting in a decline in investment. Any such fall in investment spending could further dampen business expectations in the gold sector which is already depressed due to the current gold prices.

12. Excess Deductions

12.1 Current Position

Special rules currently enable resource companies to carry forward excess mining deductions. Excess deductions include expenditures incurred during the exploration and mine development stages of a gold project. Such expenditures would typically consist of geological mapping, surveys, and drilling costs incurred in the exploration stage, and site preparation costs at the development stage. The deductibility of exploration and other mining costs is specifically provided for in Division 330 of the Income Tax Assessment Act 1997 ("the 1997 Act").

The *Review* considers that the rules about excess deductions are open to exploitation. This view results from the fact that unlike the company and trust loss provisions, there are no safeguarding measures in relation to continuity of ownership and income injection (same business test). This could allow the trafficking of excess deductions of the type that the company and trust loss provisions seek to prevent for losses generally.

The AGC has considered the above issues raised by the *Review*. However, the AGC does not consider that the current rules are being exploited. If this was the case then the wide sweeping anti-avoidance rules would have been applied to eliminate the exploitation. This has not been the case. Accordingly, the AGC considers that the system is not being exploited.

There is also the other important point being that the rules about excess deductions have been designed for the purpose of facilitating investment, in mining and for this reason alone the rules must be flexible for them to operate efficiently. This is discussed further below.

12.2 Submission

The mining legislation contained in Division 10 of the Income Tax Assessment Act 1936 (“the 1936 Act”) provided for the preservation of tax deductions for exploration and prospecting costs incurred in the development of resource projects in Australia when a mining or exploration project was sold. This policy was adopted by Parliament to recognise the high risks associated with the development of resource projects and to encourage exploration and mining projects in Australia.

A specific example of a rule designed to encourage mining investment is the operation of section 122B of the 1936 Act. Section 122B permitted the seller and buyer of a mining or prospecting right to agree to include a specified amount in the buyer’s tax deductible allowable capital expenditure. The amount that could be specified in such an agreement was limited to the purchase price of the right or information and included any recoupment of tax deductions related to the right that was sold. The effect of such an agreement was to preserve a tax deduction for costs incurred by the seller by passing the right to those deductions to the buyer of the right. This enabled the deductions which related to the mining right to be correctly matched against the income that would be ultimately derived from the mining right.

The policy of Parliament is embodied in section 330-235 of the 1997 Act which provides that the seller and buyer of a mining or prospecting right can reach an agreement on the same terms as section 122B of the 1936 Act.

There are various other examples of industry specific deductions for the resources industry which were designed to promote investment. For example, the continuity of ownership and same business test rules which apply to company tax losses currently have no application in relation to excess mining deductions.

Example

- Company A invests in gold projects.
- Company A wishes to invest in gold project X. It achieves this by purchasing all of the share capital of an unrelated company, Company B.
- At the time of purchase Company B has carried forward exploration expenditure of $1 million which was incurred on gold project X.

Under the current rules Company B (now controlled by Company A) is not required to satisfy the same business tests when claiming excess exploration deductions in future years. Rather, to claim a deduction Company B must satisfy the tests of either carrying on exploration or mining activities. The *Review* proposes that these rules can be exploited.

The AGC believes that the excess deduction rules are not being exploited. If this was the case the wide sweeping anti-avoidance provisions (Part IVA) would have been applied to eliminate the proposed exploitation.

It is also important to note that the tax loss rules referred to by the *Review* cannot be applied to excess mining deductions. Clearly, a gold exploration company which fails the continuity of ownership test would **never** be able to satisfy the same business test during the mining stages of a project. This is because during the exploration stages no income is derived, whilst in the mining stage income is derived from gold sales. Accordingly, the new transaction test would be failed and therefore the same business test. This outcome would clearly disadvantage the gold industry.

Finally, it must be recognised that the rules relating to the deductibility of exploration and mining expenditure have been designed in such a way as to facilitate investment in mining projects. This can only be achieved by providing flexibility and certainty. This cannot be achieved if the excess deduction rules are altered. The AGC believes that the current rules are satisfactory and **do not** need amending.

13. Consolidation of Entity Groups

13.1 Review Options

The *Review* highlights that existing rules give rise to high compliance costs, potential double counting of gains and losses, and CGT value shifting problems. The *Review* also notes that the current rules act as an impediment to business reorganisations.

A simplification of the existing rules is expected to result from the *Review* options. For example, all intra-group transactions and interests would be ignored and all losses, franking credits and foreign tax credits would be pooled within the group. There would be no taxation consequences on the liquidation of a group subsidiary, the buy back of shares in a group company or intra-group dividends. Consolidation is to be optional, but the current grouping provisions would be abolished.

Groups choosing to consolidate would be required to have a resident holding entity at the head of the group. Once an election is made, all the holding entity's Australian resident wholly owned companies and trusts both now and in the future would be included in the group. This is referred to as the 'all in' principle. This principle could be avoided by issuing one share in a particular company outside the group. Once the election is made it cannot under the proposals be revoked. Company groups which elect not to enter the consolidation regime will be taxed as separate legal entities.

The consolidated group would lodge a single tax return and make consolidated tax payments. Records currently maintained by each entity for tax purposes, for example carry forward tax losses, foreign losses, foreign tax credits and franking accounts would be kept on a consolidated basis, thereby presumably streamlining administration. As the consolidated group would be treated as a single tax entity any intra-group transactions would be ignored for tax purposes. This could provide for the deferral of recognition of income which would otherwise be recognised under current reporting requirements.

Upon consolidation all intra-group interests in a wholly owned entities equity are ignored. It will be therefore necessary to reconstruct the cost base of an entity sold outside the group. The first option takes the entity's equity cost base at the time of entry into the consolidated group (ie the amount paid for the shares in a company or units in a unit trust), to which is added any net increase in the entity's cost base during the period it was in the group. The alternative option takes the entity's equity cost base at the time of entry into the consolidated group, which is then attributed to the individual assets of the entity (including goodwill) and replaces the assets' cost bases. The cost base of the equity on sale is the sum of the cost bases of the underlying assets at that time.

Taxing groups as a single entity is expected to result in a progressive step towards a fairer, simpler taxation regime for companies and trusts. The principles outlined in the paper place the emphasis on facilitating simplification while protecting the tax revenue base.

13.2 Submission

The AGC notes that the above options are designed to provide an overall simplification of the current tax system and provide compliance savings for large groups who choose to consolidate. Further advantages include the ability to group franking credits without the need to pay dividends and the ability to borrow to acquire target companies without the need to push acquisition debt down to the operating company level to achieve effective deductibility of interest.

The underlying incentive for Government in replacing the existing rules is that it is likely that the consolidated group rules would limit the ability of companies and other entities to claim tax losses. For example, one review option is to limit prior year losses from being transferred into the group on consolidation. The review proposes that even if the continuity of ownership or same business test is satisfied, a loss could only be brought into the consolidated group if the entity would have (or would have been likely to have) been able to use the tax loss within a certain period (say one year) had the entity remained outside the group. This option is rejected by the AGC.

With many entities posting losses in the current depressed gold market any denial of past losses within the group would be inequitable and place unwarranted tax burden upon the gold industry. Further, the consolidation regime will be much more restrictive and will provide less overall flexibility.

By replacing the existing grouping rules with optional consolidation, entities that choose not to consolidate would no longer be able to transfer losses and roll-over assets between wholly owned group companies. This outcome would be inappropriate as past losses could remain unutilised as it would not be possible to transfer them outside the entity. The proposed rules must, therefore, be extended to cover situations where consolidation is not possible. A more equitable proposal is required to provide entities with access to grouping provisions should they choose not to or be unable to consolidate. If such a solution is not available then it would seem appropriate to leave the current system as is.

The consolidation proposals are further complicated by the requirement that there must be a resident holding company at the top of the consolidated group. This may cause problems for overseas groups with Australian subsidiaries held directly by their overseas parent. If the resident holding company is wholly owned by a foreign company other wholly owned subsidiaries in Australia held directly by that foreign company may not be consolidated in the group. Under the proposals they will no longer be able to transfer losses or roll-over assets if they cannot be consolidated.

There will also be implications for consolidated groups where an entity is sold outside the group. Upon consolidation all intra-group interests in each company’s equity are ignored, however, in the situation of a disposal to an outside party it would be necessary to reconstruct the cost base of that entity under one of two proposed options. Both models require the adjustment of cost bases of equity and group entities which could produce significant problems. Also, a company leaving the group would be denied their losses, franking credits and carried forward excess foreign tax credits as such amounts would remain with the holding entity of the group. This is a significant issue for entities looking to acquire gold projects as the entity to be acquired will not have access to past deductions that could make a high risk project viable.

The AGC does not expect that there will be compliance savings and simplification under the proposed measures. This is because significant resources would be required to prepare a consolidated group tax return. For example, there would need to be standardisation of programs, practices and policies in the group and significant costs incurred to harmonise all facets of the group (eg upgrading software packages, training costs, etc).

14. Loss Carry Back

14.1 Current Position

Winding up and mine closure costs are referred to as 'black hole' expenditures. Such expenditure's are undertaken for the purpose of earning assessable income but currently do not qualify either for a deduction or a write-off.

14.2 Review Proposal

The *Review* considers that the possible treatment of winding up and closure costs will be deductible at the time incurred. However, the AGC consider that these tax deductions may be worthless and that there is an argument for a limited form of loss carry back to ensure an appropriate recognition against income.

14.3 Submission

Loss carry back is the offset of current losses against tax already paid in earlier years. It provides a form of correctly matching revenues against expenses. Most countries allow some form of carry-back of operating losses although in most instances the period may be very short, usually no more than two to three years. Australia is one of a few countries including New Zealand, Singapore, Sweden and Taiwan that does not allow any form of loss carry back. Japan, who previously suspended loss carry backs has a commitment to reinstate its provisions from 2000.

One of the more unusual forms of loss carry back is found in France where taxpayers are permitted to carry back losses to earlier years where tax has been paid. This allows the taxpayer to earn a non interest bearing credit which can be carried forward to offset against a future tax liability. If the credit is not used within a five year period it is refunded.

A study by the Colorado School of Mining indicated that loss carry back is a tax incentive used by nations including Canada, Chile, and the United States. Significantly, the study showed that Chile was the most fiscally attractive. With a high proportion of nations providing some form of loss carry back it would be advantageous for the *Review* to consider a policy to enable the carry back of losses in certain circumstances.

For example, a loss carry back mechanism would allow taxpayers to carry back mine closure costs over the previous mine life. Currently winding up or closure costs would be non-deductible. In the gold industry a loss carry back is especially important due to high mine closure costs.

15. Exploration and Prospecting Expenditure

15.1 Current Position

Subdivision 330-A of the 1997 Act provides for the immediate deduction of capital expenditure incurred in prospecting and exploration by eligible mining (including petroleum) or quarrying operations. These rules (initially part of the 1936 Act) were introduced to recognise the high levels of risk and capital expenditure associated with minerals exploration and were designed to encourage the discovery of new deposits. The immediate deductibility of exploration expenditure acknowledges that such expenditure is an ongoing and necessary expense incurred by resources companies.

15.2 Submission

The AGC supports the immediate deductibility of exploration expenditure:

- Exploration expenditure is considered to be a normal business expense incurred by gold mining and exploration companies and should be deductible as incurred.

- Exploration is high risk and therefore must be encouraged to ensure that new mineral deposits are identified. Without new projects to replace existing mines the impact on the Australian economy in future years will be significant (eg fall in exports).

- There is a significant economic multiplier effect when expenditure is incurred on exploration. This multiplier effect is important as it supports the future of regional Australia, an area forgotten by other key industries.

- Significant exploration activity is required to support the long term future of the mining industry.

- Furthermore the AGC requests confirmation that all forms of native title compensation (whether by royalty or lump sum payments) paid to native title holders as compensation for carrying out exploration and development activities, are also immediately deductible.

16. Research and Development

16.1 Overview

Broadly, section 73B of the 1936 Act provides for a deduction (150 per cent for expenditure incurred before 7.30pm EST on 20 August 1996 and 125 per cent for expenditure incurred after that time) for expenditure incurred on R&D activities. The R&D incentive was a significant stimulus introduced in the 1980's. The R&D scheme has brought with it significant benefits to the Australian economy.

16.2 Submission

The AGC supports the retention of the existing R&D measures.

- R&D results in new technology which can improve the efficiency of business operations significantly.
- The ability to write-off capital expenditure on prototype, pilot plants and research facilities is a significant benefit and helps promote R&D activity.
- R&D activities produce spillover benefits to industries which do not undertake the R&D themselves.
- Maintaining the international competitiveness of the Australian tax system for R&D is also important. The *Review's 'An International Perspective'* paper noted all 26 countries considered in that paper provided some form of tax preference for R&D.
- Reducing or abolishing the provision would remove a useful stimulant to investment, reducing the net benefits of the provision to the Australian economy.