

10 August 2020

[REDACTED]
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Department of Industry, Science, Energy and Resources

(via email: [REDACTED])

Dear [REDACTED],

APPEA Submission: Junior Minerals Exploration Incentive Review

Executive Summary

The Australian Petroleum Production & Exploration Association (APPEA) is the preeminent national body that represents companies engaged in oil and gas exploration and production operations in Australia. These companies make a significant contribution to the Australian economy by:

- paying more than \$250 billion – in today's dollars – to governments through resources charges and company tax
- supporting the employment of 80,000 workers both directly and indirectly
- developing infrastructure and supporting wealth creation in regional communities
- safeguarding the continuity of supply domestically and to our global trading partners, and
- ensuring Australia can achieve 2050 emissions targets.

Exploration investment and activity has underpinned the strong contributions made by Australia's oil and gas industry. However, the strong economic headwinds faced by the Australian economy will challenge the investment environment for junior explorers and the right investment settings are now more critical than ever.

The Junior Minerals Exploration Incentive ("JMEI") supports the investment environment for junior explorers. It allows junior explorers to attract scarce and mobile capital the international competition for which is greater than it has perhaps ever been. However, expenditure on petroleum (oil and gas) activities are excluded from being converted to exploration credits and this therefore diminishes the ability of junior petroleum explorers to attract further investment capital necessary for growth.

APPEA therefore recommends:

- the JMEI be extended for a further four years with an increase of funding to \$200 million, and
- that paragraph 418-80(2)(b) of the *Income Tax Assessment Act 1997*¹ be removed to allow junior petroleum explorers to access the significant benefits of the JMEI.

¹ All legislative references are to the *Income Tax Act 1997* unless otherwise stated.

Investment in petroleum exploration companies

Junior exploration companies are a critical part of the resources industry ecosystem. By virtue of their size and agility, these companies are able to take on greater risk and in doing so identify and firm up resources for future development and critically, Australian energy supply and security.

Attracting investment to conduct these activities can be complex and high risk. It requires the commitment of significant upfront costs and can have lower rates of success. The lack of certainty on exploration success makes it very difficult for prospective investors to adequately evaluate the risks and returns associated with investing in these companies. This makes attracting additional capital difficult whilst junior explorers navigate prolonged periods of no revenue - in some instances, more than 15 years - before any return on investment is made.

It is common for junior explorers to incur high expenditure and endure many years of losses. As a result, these companies typically have no taxable income and accumulate tax losses that they may not be able to recoup. The asymmetric treatment of tax losses compared with profits can impede risk taking and the investment of capital in junior explorers. In combination, these factors introduce an unwelcome source of uncertainty to investor decisions, which inhibits their ability to evaluate the returns to minerals exploration activities.²

The challenges faced by junior explorers are different to larger, well established companies that are generally able to fund such activities from their own profits. Smaller companies focused solely on exploration are dependent on attracting investment to fund their activities.³

Extending the JMEI for a further four years

APPEA broadly supports the policy intent and design of the JMEI. We observe that the JMEI represents a significant improvement to its predecessor, the Exploration Development Incentive in that it removed some of the uncertainties associated with entitlements to credits, the issuing of credits, the use of a modulation factor and the allowance for farm-in farm-out arrangements to be used.

APPEA also supports the integrity exclusion in paragraph 418-75(1)(d) to ensure that the JMEI is only accessible by junior explorers that are only conducting exploration activities. The exclusion precludes a junior explorer from accessing the JMEI where it or an entity “connected with”⁴ it, is carrying on mining operations.

APPEA would therefore strongly support the extension of the JMEI for a further four years, especially given the current economic challenges faced by junior explorers. Given that it has been oversubscribed, APPEA also supports that the JMEI funding be increased to \$200 million.

² Paragraph 3.14 and 3.15 of the Explanatory Memorandum to the *Treasury Laws Amendment (Junior Minerals Exploration Incentive) Bill 2017* (“the Explanatory Memorandum”).

³ Paragraph 1.7 of the Explanatory Memorandum.

⁴ This includes entities that are affiliated.

Removing the petroleum exploration expenditure exclusion in paragraph 418-80(2)(b)

Where the JMEI is extended for a further four years, APPEA also recommends that paragraph 418-80(2)(b) be removed. This paragraph works to exclude expenditure on petroleum (oil and gas) exploration activities from being included in the definition of “eligible expenditure”. As a result, expenditure on petroleum exploration activities cannot be converted to exploration credits and in effect, precludes junior petroleum explorers from accessing the JMEI.

APPEA notes that the term ‘minerals’ is a defined term for the purposes of the *Income Tax Assessment Act 1997*. In accordance with subsection 40-730(5), minerals is taken to include petroleum.

Petroleum is subsequently defined in subsection 40-780(6) to be:

- (a) any naturally occurring hydrocarbon or naturally occurring mixture of hydrocarbons, whether in a gaseous, liquid or solid state; or
- (b) any naturally occurring mixture of:
 - (i) one or more hydrocarbons, whether in a gaseous, liquid or solid state; and
 - (j) one or more of the following: hydrogen sulphide, nitrogen, helium or carbon dioxide; whether or not that substance has been returned to a natural reservoir.

Therefore, the removal of paragraph 418-80(2)(b) is a simple and efficient amendment and one that is consistent with the broader policy intent of the JMEI.⁵ That is:

“...to encourage additional investment in small exploration companies undertaking greenfields minerals exploration in Australia.”⁶

Support for extending the JMEI and removing paragraph 418-80(2)(b)

Like many Australian businesses, exploration companies have been materially impacted by COVID-19. Many are seeing delays to exploration and appraisal programs and are struggling to access capital. Nevertheless, they remain committed to maintaining their workforce as much as they can during these uncertain times.

Access to a scheme like the JobKeeper subsidy would have provided the support necessary to ensure these companies can continue to employ people and ensure they are not lost to an industry that is critical to Australia’s future prosperity. However, junior explorers are ‘pre-revenue’ and therefore cannot access the JobKeeper scheme due to their inability to satisfy the decline in turnover tests.

Current economic challenges faced by junior explorers further support the recommendations in this submission. The onset of the COVID-19 pandemic has only increased the challenges faced by junior explorers. A smaller pool of capital that will be more mobile and subject to tighter hurdle rates will see investment in junior explorers become challenging.

⁵ APPEA notes that there will need to be some minor consequential amendments made to remove references to petroleum where it is present throughout Division 418. For example, see subsection 418-75(d).

⁶ Page 8 of the Explanatory Memorandum.

This is clearly a need for additional support for junior explorers. Without additional support such as that offered by the JMEI, the impacts on the long-term health of the resources sector, the jobs it creates and the contribution it makes to the economy as a whole will be impacted significantly.

Further it will continue to ensure that the long term contribution made by the resources sector can continue. This is consistent with paragraph 1.7 of the Explanatory Memorandum which notes:

“The extraction and sale of mineral resources makes a significant contribution to the Australian economy. Ongoing exploration and the discovery of new mineral resources are vital to the longer term future of the resources sector.”.

APPEA would therefore strongly support the extension of the JMEI for a further four years and the removal of paragraph 418-80(2)(b), especially given the current economic challenges faced by junior explorers. In combination, these recommendations will assist junior explorers engaged in petroleum exploration to attract scarce and mobile capital.

Why greater support for petroleum exploration in Australia is needed

Australia’s success as a supplier of petroleum (i.e. oil and gas) has been made possible by a long-term commitment to exploration. Without exploration, future production will decline, compromising Australia’s energy security and prosperity.

Exploration activity (measured by wells drilled) has been falling (both onshore and offshore) for a number of years. Looking ahead, the most recently disclosed exploration work programs show a very modest recovery may be underway however, the impacts of COVID-19 create greater uncertainty.

The causes of the fall in exploration are complex. Commodity prices is just one of the factors responsible for declining exploration; others include regulatory creep, a lack of prospective new acreage, data gaps, diminished access to capital and impediments that are placed on access by governments.

Australia needs to maintain a stable, attractive policy environment to reverse the decline in petroleum exploration investment. It is even more critical given that the onset of the COVID-19 pandemic will see global investment capital becoming more scarce and likely to be invested in jurisdictions with the best commercial prospects.

Chart 1: Offshore Exploration Wells and expenditure

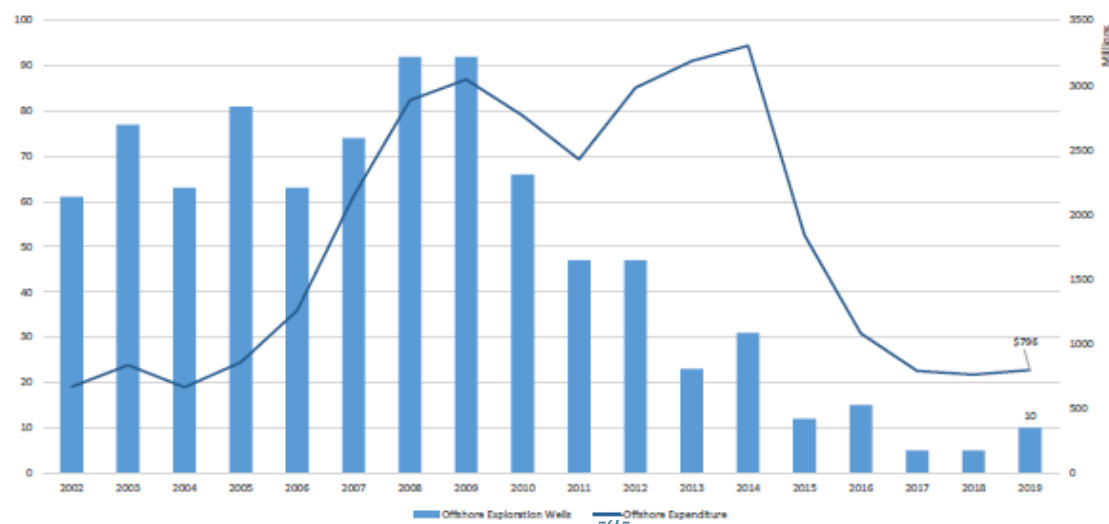
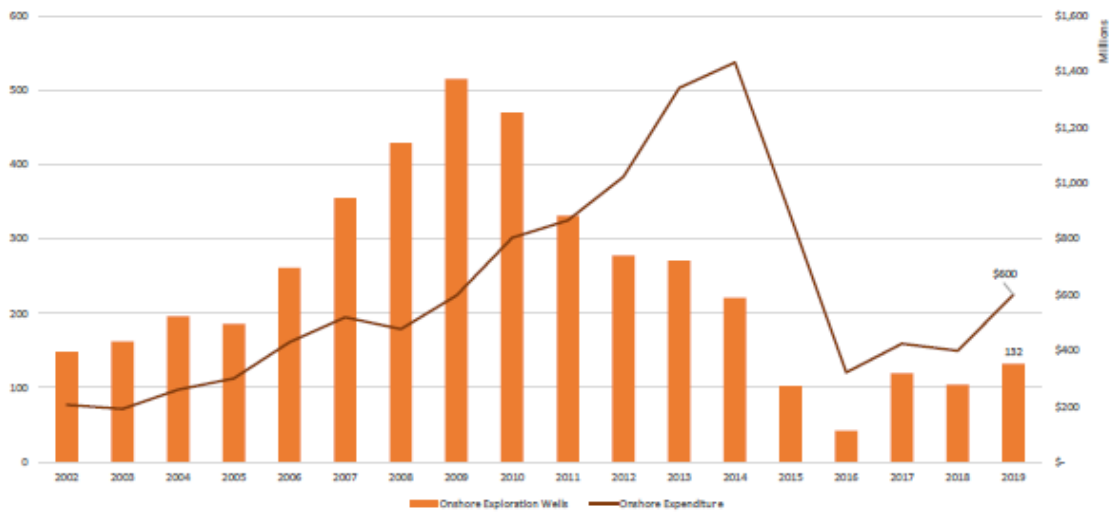


Chart 2: Onshore Exploration Wells and Expenditure



Source: APPEA

Concluding remarks

The contributions made by Australia’s oil and gas industry are especially relevant given the current strong headwinds our economy faces. The onset of the COVID-19 pandemic will see the Australian economy embark on a program of stabilisation and recovery, a program that will be strongly supported by Australia’s oil and gas industry provided the investment and operational environments and conducive to further advancing or replicating these contributions.

Exploration will underpin this stabilisation and recovery work program and will continue to be a vital cog in Australia’s economic recovery. COVID-19 will challenge many junior explorers’ ability to continue to attract scare and mobile capital and without access other stimulus package benefits such as JobKeeper, may not survive these unprecedented times.

Therefore, APPEA believes that the removal of paragraph 418-80(2)(b) is now required and will promote increased investment and exploration activities in Australia’s oil and gas industry.

APPEA would welcome the opportunity to discuss this submission with you further. If you have any queries or for further information in relation to the contents of this submission, you can contact Simon Staples – Director, Commercial on 0403 152 157 or at sstaples@appea.com.au.

Yours sincerely,

Andrew McConville
Chief Executive