



Income Tax Assessment Act 1997 – Exploration Development Incentive Modulation Factor – Declaration Instrument (No. 1) 2015

Explanatory Statement

General Outline of Instrument

1. This instrument is made under subsection 418-90(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).
2. The instrument declares that the modulation factor for the 2015-16 income year is 1.
3. The instrument is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

Date of effect

4. The instrument commences on the day after its registration on the Federal Register of Legislative Instruments.

What is this instrument about

5. The purpose of this instrument is to declare the modulation factor for the exploration development incentive for the 2015-16 income year.

What is the effect of this instrument

6. The effect of this instrument is that the modulation factor for the 2015-16 income year is 1.
7. The modulation factor ensures that the total amount of exploration credits created by entities cannot exceed the exploration credit cap for the relevant income year (\$25 million for 2015-16).
8. Entities must apply the modulation factor in working out their maximum exploration credit amount for the relevant year.
9. An assessment of compliance cost impacts indicates that this legislative instrument will have no or minimal impacts for both implementation and ongoing compliance costs. The legislative instrument is minor or machinery in nature.

Background

10. Subsection 418-90(1) of the ITAA 1997 provides that the Commissioner must declare, by legislative instrument, a modulation factor for the exploration development incentive for the 2015-16 income year.
11. The total financial impact of the exploration development incentive, in terms of the value of tax offsets and franking credits that shareholders of entities may receive, is limited by the exploration credit cap. For the 2015-16 income year the exploration credit cap is \$25 million.
12. The modulation factor is calculated by the Commissioner to ensure the exploration credit cap is not exceeded. The modulation factor is used by entities in working out the maximum exploration credit amount of credits they can issue in the 2015-16 income year.
13. The Commissioner calculates the modulation factor using the following formula:

$$\frac{\text{Exploration credit cap expenditure amount}}{\text{Total notified exploration expenditure amount}}$$

where:

Exploration credit cap expenditure amount is the amount that is equal to the exploration credit cap for the 2015-16 income year (\$25 million) divided by the corporate tax rate for the 2014-15 income year (30%).

Total notified exploration expenditure amount is the sum of amounts notified to the Commissioner by each entity under subsection 418-70(1) of the ITAA 1997¹ in each case being the lesser of the two amounts notified (estimated greenfields minerals expenditure and estimated tax loss (if applicable) for the 2014-15 income year).

14. The modulation factor is the amount calculated using the above formula if that amount is less than 1.
15. The modulation factor is 1 if the amount calculated using the above formula is or is greater than 1.
16. The modulation factor is applied at step 3 of the method statement for working out an entity's maximum exploration credit amount under subsection 418-85(2) of the ITAA 1997. Broadly, this process has regard to the lower or lowest of the entity's estimated and actual exploration expenditure (or estimated or actual tax loss if applicable) for the previous income year and the previous year company tax rate (30% for 2014-15).
17. To protect taxpayers from potentially significant compliance costs and penalties in respect of something that is wholly beyond their control, this instrument is not subject to disallowance (see subsection 418-90(6) of the ITAA 1997).
18. Further, in the event of an error by the Commissioner, the validity of the Commissioner's declaration of the modulation factor for an income year is not

¹ Estimated greenfields minerals expenditure and tax loss amounts need to be reported to the Commissioner by 30 September in the financial year corresponding to the following income year to allow the Commissioner to work out the total notified exploration expenditure amount and modulation factor. Calculating the modulation factor using estimated amounts for the previous income year reduces the time lag that would otherwise apply for creating exploration credits if actual amounts were required to calculate the modulation factor.

affected if the Commissioner errs in complying with the exact technical process set out for the calculation of the modulation factor (see subsection 418-90(5) of the ITAA 1997).

Consultation:

19. The Energy and Resources Working Group were consulted on the process and mechanism for the calculation of the modulation factor. The Working Group's membership includes representatives of major tax, law and accounting associations and representatives of resource industry associations, including the Australian Association of Mining and Exploration Companies (AMEC).
20. Wider consultation was not considered necessary as only entities who are members of the mining industry can pass on the benefit of the exploration development incentive.

Jeremy Hirschhorn
Deputy Commissioner of Taxation
12 November 2015

Legislative references:

Income Tax Assessment Act 1997

Human Rights (Parliamentary Scrutiny) Act 2011

Legislative Instruments Act 2003

Statement of compatibility with Human Rights

This Statement is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

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Under subsection 418-90(6) of the *Income Tax Assessment Act 1997* this instrument is exempt from disallowance and therefore a Human Rights Statement of compatibility is not required.