



Chartered Accountants
& Business Advisers

17 October 2008

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

Submission – Australia’s Future Tax System

PKF Western Australia welcomes the opportunity to participate in the community consultation process in relation to the comprehensive review of Australia’s tax system.

We attach our submission for consideration by the Review Panel. We note the challenges contained in the *Terms of Reference*; particularly item 3 that,

“The comprehensive review of Australia’s tax system will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia’s economic and social outcomes.”

Notwithstanding the impressive hurdles set by the *Terms of Reference* we seek to support the Review Panel in its task ahead and trust that the attached submission may be part of the process that contributes to the achievement of the goals set.

We wish the Review Panel every success in its mandate. Should the Review Panel wish to discuss any aspect of this submission, please do not hesitate to contact me on 08 9278 2208.

Yours sincerely

John Murray
Tax Partner

Tel: 61 8 9278 2222 | Fax: 61 8 9278 2200 | www.pkf.com.au
West Australian Partnership | ABN 39 542 778 278
Level 7, BGC Centre | 28 The Esplanade | Perth | Western Australia 6000 | Australia
PO Box Z5066 | St Georges Terrace | Perth | Western Australia 6831

PKF is a national association of independent chartered accounting and consulting firms, each trading as PKF. PKF Australia Ltd is also a member of PKF International, an association of legally independent chartered accounting and consulting firms.

Liability limited by a scheme approved under Professional Standards Legislation

1.0 Executive Summary

We propose the following be considered by the Review Panel:

The *Income Tax Assessment Act 1997* is amended to enable the existing exploration and prospecting deductions contained in section 40-80 and section 40-730 to apply to the geothermal industry.

The *Income Tax Assessment Act 1997* is amended by introducing a flow through share scheme to enable Australian resident shareholders of Australian public companies a tax credit calculated by reference to the amount of exploration expenditure incurred by those companies within Australia.

2.0 Geothermal Industry Support

Our submission notes the Government's comments in *The Green Paper on the Carbon Pollution Reduction Scheme*¹ ("the Green Paper"),

Substantially reducing Australia's national emissions will involve the most significant structural reform of the economy since the 1980's. This reform process will not be easy and involves significant challenges. Meeting these challenges will require the Government to implement responsible economic policies focused on reducing emissions at the lowest possible cost in the context of a complex and challenging macroeconomic environment."²

Against this background the *Green Paper* described the review of *Australia's Future Tax System* in the following terms,

*"Reforms being progressed by the Government to enhance productivity and participation across the economy – including through the COAG National Reform Agenda and the Australia's Future Tax System Review – are designed to further strengthen Australia's economy."*³

In the paper *Architecture of Australia's Tax and Transfer System*, the following comments are made,

*"Australia faces significant economic, social and environmental challenges. The tax and transfer system will have a key role to play in how well we meet these challenges to secure Australia's future prosperity and living standards of Australians."*⁴

Further, in this paper it was noted,

*The tax-transfer system is a fundamental part of the social and economic infrastructure of Australia. Its evolution reflects the demands and expectations of Australians, especially in relation to the balance between private and public provision of goods and services, and the level of income redistribution that should occur. These roles must be financed by government revenue."*⁵

In general terms it appears in the past, the potential for Australia's geothermal industry has been understated. This is evidenced by the data disclosed in Appendix One to this submission.

¹ *The Green Paper on the Carbon Pollution Reduction Scheme*, Department of Climate Change, July 2008.

² *The Green Paper on the Carbon Pollution Reduction Scheme*, supra, at page 10.

³ *The Green Paper on the Carbon Pollution Reduction Scheme*, supra, at page 10.

⁴ *Architecture of Australia's Tax and Transfer System* Department of Treasury, August 2008 at page iii.

⁵ *Architecture of Australia's Tax and Transfer System* Department of Treasury, August 2008 at page 3.

In more recent times, this has changed. This is evidenced by the comments in the draft *Geothermal Industry Development Framework* released by the Australian Department of Resources Energy and Tourism during August 2008, in which it is stated,

“Australia’s geothermal energy resources have the potential to become a significant source of secure, renewable and low-emission baseload power for the future. Preliminary resource evaluation work has suggested that extracting just one percent of the energy from rocks hotter than 150°C and shallower than 5,000m would yield ~190 million PJ of energy or about 26,000 times Australia’s primary power usage in 2005.

To date, geothermal energy has played a minimal role in Australia’s energy mix, with only one small remote plant in operation in Birdsville, Queensland. During the last decade, however, interest in geothermal energy has increased significantly due to two major factors. Firstly, research into Australia’s geothermal resources has provided evidence that electricity generation from geothermal sources is possible in Australia. Secondly, the challenge posed by climate change has become a significant driver for policy development by Australian governments at all levels.

*As a result, there has been significant growth in the number of private sector companies seeking to produce geothermal energy in Australia.”*⁶

Consistent with the focus of the Review Panel on environmental and social issues, we recommend that amendments are made to the *Income Tax Assessment Act 1997* to enable taxpayers engaged in the geothermal industry to obtain an immediate deduction for exploration activities.

There are currently two primary provisions that enable taxpayers carrying out certain exploration activities to obtain an immediate tax deduction for these activities; section 40-80 of the *Income Tax Assessment Act 1997* and section 40-730 of the *Income Tax Assessment Act 1997*.

Section 40-80 operates to allow a taxpayer to claim an immediate deduction for the cost of a depreciating asset that is first used for exploration and prospecting for minerals or quarry materials, obtainable by mining operations, where other tests are also met.

Section 40-730 operates to allow a taxpayer for certain expenditure incurred by a taxpayer on exploration or prospecting for minerals or quarry materials obtainable by mining operations where certain other tests are met and the expenditure does **not** relate to the cost of a depreciating asset.

“Exploration or prospecting” in this context includes activities for mining in general and it is unclear that this would naturally cover geothermal exploration activities.

“Mining operations” in this context means mining operations on a mining property for extracting minerals from their natural state. It is unclear that taxpayers engaged in geothermal activities are searching for “minerals”.

In order to support this important industry and in view of the similarity in a general sense, between the activities that a mining company would carry on in exploring for minerals compared with the activities a geothermal company carries on in identifying “hot rocks”, we consider it is sensible that the geothermal industry be allowed an immediate deduction for these activities.

⁶ *Geothermal Industry Development Framework*, Draft Report released by the Australian Department of Resources Energy and Tourism, August 2008, AGPS.

Recommendation:

The *Income Tax Assessment Act 1997* is amended to enable the existing exploration and prospecting deductions contained in section 40-80 and section 40-730 to apply to the geothermal industry.

3.0 Flow Through Shares

In the Australian Labour Party Document "*Securing A Sustainable Energy Supply For Australia's Future*"⁷, the Australian Labor Party undertook amongst other things, to secure future fuel supplies by introducing a selective flow through share scheme for the oil industry.

This followed much research undertaken by various organisations, including but not limited to the Association of Mining and Exploration Companies Inc,⁸ the Australian Petroleum Production and Exploration Association,⁹ the Minerals Council of Australia,¹⁰ the Australasian Institute of Mining and Metallurgy¹¹

We believe there is a need to address the decline in available capital to support ongoing exploration activity, particularly in the face of the depressed stock market in recent months. An appropriately devised flow through share scheme could assist this vital industry in positioning Australia to secure energy needs from an oil and gas perspective and maintain its economic strength in the marketplace from a mining perspective.

There are a number of excellent models that have been created in this regard and we believe that urgent attention should be given to introduce a model that ensures the industry is supported with minimal risk for exploitation.

Recommendation:

The *Income Tax Assessment Act 1997* is amended by introducing a flow through share scheme to enable Australian resident shareholders of Australian public companies a tax credit calculated by reference to the amount of exploration expenditure incurred by those companies within Australia.

⁷ *Securing A Sustainable Energy Supply For Australia's Future*, Australian Labor Party, Senator Chris Evans, Election 2007.

⁸ Refer *The AMEC Explorer* December 2007

www.amec.org.au/media/docs/AMEC%20Explorer%20-%20December%202007.pdf

⁹ Refer to *Platform for Prosperity* Strategic Leaders Report, page 23, Option 1.2.6, Australian Petroleum Production and Exploration Association

¹⁰ Refer *The Case For a Flow Through Share Scheme for Minerals Exploration*, Mitchell Hooke, Minerals Council of Australia, 11 April 2006

www.minerals.org.au/_data/assets/pdf_file/0017/11555/MHH_OpEd_Exploration110406.pdf

¹¹ Refer *Mining Industry Pins Hope of Flow Through Shares, as Canadian Ant Overshoots Australian Grasshopper*, Monica Sarder, AusIMM,

www.ausimm.com.au/content/docs/min_ind_pins_hopes_canadian.pdf



Chartered Accountants
& Business Advisers

SUBMISSION TO THE REVIEW PANEL

AUSTRALIA'S FUTURE TAX SYSTEM

4.0 Conclusion

We believe the above recommendations align with the scope of work undertaken by the Review Panel.

Please do not hesitate to contact us should you wish to discuss these matters further.

PKF Chartered Accountants and Business Advisers
Perth

APPENDIX ONE

Federal and State grants awarded for geothermal RD&D in Australia 2000– February 2007

Grant	Date	Recipient	Project	Amount (\$AUS)
RECP	2000	Pacific Power/ANU	Hunter Valley Geothermal Project	\$ 790,000
START	2002	Geodynamics Ltd	Habanero Project	\$ 5,000,000
REEF	2002	Geodynamics Ltd	Habanero Project	\$ 1,800,000
GGAP	Mar 2005	Geodynamics Ltd	Kalina Cycle to produce 13 MW from waste heat at the Mt Keith Nickel Mine in WA	\$ 2,080,000
REDI	Dec 2005	Geodynamics Ltd	Habanero Project, Cooper Basin, SA	\$ 5,000,000
REDI	Dec 2005	Scopenergy Ltd	Limestone Coast Geothermal Project, SA	\$ 3,982,855
PACE 2	Apr 2005	Petratherm Ltd	Paralana Geothermal Project, SA	\$ 140,000
PACE 2	Apr 2005	Scopenergy Ltd	Limestone Coast Geothermal Project, SA	\$ 130,000
PACE 2	Apr 2005	Eden Energy Ltd	Witchellina Project, SA	\$ 21,000
PACE 3	Dec 2005	Geothermal Resources Ltd	Curnamona Geothermal Project, SA	\$ 100,000
PACE 3	Dec 2005	Green Rock Energy Ltd	Olympic Dam Geothermal Project, SA	\$ 68,000
REDI	July 2006	Geothermal Resources Ltd	Frome Geothermal Project	\$ 2,400,000
REDI	Dec 2006	Proactive Energy Developments Ltd	Novel regenerator for adapting supercritical cycles to geothermal power application	\$ 1,224,250
PACE 4	Dec 2006	Torrens Energy Ltd	Heatflow Exploration in Adelaide Geosyncline	\$ 100,000
PACE 4	Dec 2006	Eden Energy Ltd	Renmark (Chowilla) Geothermal Project, SA	\$ 100,000
PACE 4	Dec 2006	Geodynamics Ltd	High Temperature Borehole Image logging of Habanero 3, Cooper Basin, SA	\$ 100,000
REDI	Feb 2007	Petratherm Ltd	Paralana Geothermal Project, SA	\$ 5,000,000
			Total	\$28,036,105

Extract from the Primary Industries and Resources South Australia website ¹² that shows Federal and State Government support for companies in the geothermal industry operating in South Australia averages approximately A\$7million per annum for the period 2000 to 2007.

¹² http://www.pir.sa.gov.au/_data/assets/word_doc/0011/25040/Federal_and_State_grants.doc