



Class Ruling

Income tax: research and development tax incentive: membership funding for the ACA Low Emissions Technologies Program

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❶ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 355-100 of the ITAA 1997
- section 355-205 of the ITAA 1997
- section 355-210 of the ITAA 1997
- section 355-435 of the ITAA 1997
- section 82KZL of the *Income Tax Assessment Act 1936* (ITAA 1936)

- section 82KZMA of the ITAA 1936
- section 82KZMD of the ITAA 1936

All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies comprises 'R&D entities', as defined by section 355-35, who are liable for levy contributions under the ACA Low Emissions Technologies Program, and who:

- are registered with Innovation Australia, in accordance with the requirements of subparagraph 355-205(1)(a)(i) for the relevant years of income
- have notional deductions identified by reference to paragraphs 355-100(1)(a)-(g) for the relevant years of income which equal or exceed \$20,000, and
- are not a small business entity as defined in section 328-110.

4. In this Ruling the term 'Contributor' is used to refer to those companies that are ultimately obliged to pay levy contributions to ACA Low Emissions Technologies Limited (**ACALET**). In the Contribution Deed discussed below, those companies are either the 'mine owner(s)' or 'operator(s) of coal producing assets' or 'contributor(s)' where no separate 'mine owner(s)' are identified in the Contribution Deed.

5. This Ruling **does not apply** to R&D entities that are not registered for the relevant years of income with Innovation Australia. The publication of this Ruling does not relieve companies making contributions to ACALET of the obligation to make separate applications for registration of their activities under section 27A of the *Industry Research and Development Act 1986* (IR&D Act 1986).

Qualifications

6. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling. This Ruling only applies to contributions used to fund the activities undertaken in accordance with the agreement entered into between ACALET and Australian National Low Emissions Coal Research and Development Ltd (**ANLEC**) on 3 March 2010 (**Funding Agreement**).

7. Further, this Ruling does not apply to any contributions made in a relevant year of income that are less than \$1,000 (in total for that year of income).

8. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 12 to 60 of this Ruling.

9. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- this Ruling may be withdrawn or modified.

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Date of effect

11. This Ruling applies from 1 July 2011 to 30 June 2017. The Ruling continues to apply after 30 June 2017 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

12. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of, and are to be read with the description:

- application for class ruling and accompanying attachments sent via email on 27 October 2011
- letter from the applicant and accompanying attachments dated 11 November 2011

- letter from the applicant and accompanying attachments dated 24 February 2012
- letter from the applicant and accompanying attachments dated 9 March 2012
- letter from the applicant and accompanying attachments dated 4 April 2012, and
- the Minutes of the meeting that took place on 11 April 2012, between representatives of the Australian Taxation Office (ATO) and the applicant.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Background

13. The Coal21 National Action Plan was formally issued on March 2004 by the Minister for Industry Tourism and Resources, highlighting the national challenge facing Australia with substantial greenhouse gas emission impact from fossil fuel use. The plan identified options to address the greenhouse gas emissions impact by an intensive program of research and development and demonstration in the areas of low emissions technologies associated with the use of coal.

14. The Australian black coal industry accepted the need to arrange a new program consistent with the Coal21 National Action Plan. The ACA Low Emissions Technologies Program (**ACALET Program**) was established to support research, development and demonstration aimed at developing clean coal technologies. Funding for the ACALET Program is provided by way of voluntary levies.

ACALET

15. ACALET has been established to manage the ACALET Program. ACALET is not a research service provider under Division 4 of the IR&D Act 1986.

16. Clause 4 of ACALET's Constitution describes its objects, which include:

- providing for the collective and integrated research of coal for the purposes of providing strategic leadership to the coal and associated industries with particular regard to potential low emissions technologies applicable to the use of coal

- allocating the funds raised among registered research agencies and other research agencies and demonstration project agencies chosen by the company to undertake research and/or demonstration projects
- acting as a catalyst to stimulate research and development and demonstration project interest within the coal and associated industries
- improving the management and application of coal research and demonstration projects in Australia
- ensuring a more efficient use of Australia's black coal resources
- increasing the economic, environmental safety and social benefits to the coal industry and wider community
- promoting competitiveness, sustainable use and management of Australia's coal resources, and
- entering into contracts with and engaging organisations to manage research projects and/or demonstration projects on behalf of groups of companies.

17. Each coal producer group operating in Australia has the opportunity to become a member of ACALET. The Board of ACALET comprises of up to 15 directors.

18. Clause 6 of ACALET's Constitution governs membership of the company. In particular clause 6.10 provides that:

[each] Member must enter into an agreement with the Company to pay contributions or levies to the Company which will be applied towards the promotion of the objects of the Company set out in clause 4.

19. As detailed in paragraph 14 of this Ruling, participation in this arrangement is voluntary. Any payments made by a Contributor under this scheme, who is also a member of ACALET, are taken to be made voluntarily, and not in its capacity as a member of ACALET.

Contribution Deed

20. Each affected coal producer (referred to as an 'operator of coal producing assets' or 'contributor') enters into a Contribution Deed with ACALET under which they are liable to pay contributions (levies). Agency clauses are present in the agreement, which demonstrate that in some circumstances, the operator of coal producing assets is entering into the Contribution Deed on behalf of the relevant 'mine owners'.

21. The Contribution Deed sets out the rights and obligations of ACALET and the Contributor, in particular the:

- agreement to pay contributions, clause 2
- amount of the contributions, clause 3, and
- actual payment of contributions, clause 4.

22. The Contributors agree to pay levies to ACALET in consideration for its promise that they will be applied exclusively in respect of 'research and development' (**R&D**) and / or 'demonstration projects' as defined in the Contribution Deed and also for management and administration expenses in respect of R&D and / or 'demonstration projects'. Further, the Contribution Deed also requires that the results of the R&D will be made available to the Contributors to the extent possible, under the terms of the various agreements entered into by ACALET in relation to the ACALET Program.

23. Contributions accrued by a Contributor are calculated up to a maximum of \$0.20 per tonne of coal produced by the Contributor from the coal producing assets from 30 June 2007. The Contributor must pay to ACALET the amount of contribution equal to the accrual balance (which increases by quarterly sales multiplied by the rate of contribution and decreases by any payments made), unless a payment notice has issued. If it has then the Contributor must only pay the amount on the Payment Notice. Contributions are made on a quarterly basis.

24. All contributions paid to ACALET become the property of ACALET and cannot be refunded.

25. The Contribution Deed defines R&D to mean scientific, technical or economic research in connection with the beneficiation and use of coal or products derived from coal, including the demonstration and development of the results of that research and includes:

- (a) training of persons for the purpose of any such R&D
- (b) publication of reports, periodicals, books and papers in connection with such R&D
- (c) dissemination of information and advice in connection with scientific, technical or economic matters related to exploration, mining and beneficiation of coal or products derived from coal
- (d) matters incidental or relating to a matter referred to in this definition, and
- (e) matters incidental or relating to the obligations of ACALET under the Contribution Deed including costs incurred in collection of contributions.

26. The Contribution Deed defines 'demonstration project' to mean a project with the objective of demonstrating the technical and / or commercial potential of a new low emissions technology or process, and includes the application of an existing overseas technology or process to Australian circumstances.

27. ACALET will provide expenditure statements to Contributors pursuant to clause 9(d) of the Contribution Deed. This requires that ACALET provide biannual reports to Contributors indicating the apportionment of the expenditure of contributions to R&D and demonstration projects. ACALET will also provide quarterly reports to Contributors, as it recognises that companies will have a range of tax year-end dates. The quarterly reports are derived from a 'contributor reporting spreadsheet' developed by ACALET. The reports set out the Contributor's percentage of the eligible research and development expenditure (**R&D expenditure**) and other expenditure spent on the projects carried out in accordance with the Funding Agreement, or on related overheads for the quarter. It is intended that a Contributor's claim for a notional deduction under Division 355, in relation to expenditure incurred to ACALET for a particular income year, should be able to be compiled by taking the appropriate details from the quarterly reports for the four quarters falling within that taxpayer's particular income year.

28. The Contribution Deed commences on the effective date and will be reviewed by the parties during the three month period expiring on 30 June 2017. It envisages continuing to the later of such date that the parties agree upon, or the date on which the accrual balance is nil, unless terminated earlier. The effective date will vary for Contributors, as some entered into the Contribution Deed prior to 30 June 2007 and some after this date.

29. The Contribution Deed and the manner in which the program is executed provide rights to coal producers in relation to the R&D to be undertaken, such that control of the R&D resides with the Contributors.

30. Companies representing over 95% of black coal production capacity have committed to participate in the ACALET Program by making contributions to ACALET for the period 1 July 2007 to 30 June 2017.

31. The expenditure is not a 'pre-RBT obligation' as defined in subsection 82KZL(1) of the ITAA 1936.

Interaction between Australian National Low Emissions Coal Research and Development Ltd and ACALET – funding and operations

32. Contributions paid to ACALET by Contributors are (in part) used to fund the operations of ANLEC. ANLEC has been identified as a suitable vehicle through which ACALET can further the objectives of the ACALET Program due to its focus on the development of coal related technologies.

33. The Funding Agreement requires that the funds be utilised in the broad research programme undertaken by ANLEC, (**ANLEC Project**). ANLEC is expected to continue operation for a number of years.

34. All funding provided by ACALET must be used for the sole purpose of performing the ANLEC Project. ANLEC must not use ACALET funding for any other purpose.

35. The ANLEC Project is carried out under the stewardship of ANLEC, utilising funding from two primary sources, being ACALET and the Commonwealth of Australia.

36. Under schedule 3 of the Funding Agreement, ANLEC has agreed to provide ACALET with the following reports:

- Progress reports on each project, undertaking or endeavour which ANLEC funds (**Eligible Project**) in order to undertake the ANLEC Project, every 6 months
- Financial reports relating to the ANLEC Project annually
- Final report at the end of the ANLEC Project, and
- Ad hoc reports as required upon the happening of a significant event.

37. Under clause 9 of the Contribution Deed ACALET has agreed to provide Contributors with:

- a statement indicating the apportionment of the expenditure of Contributions to R&D and Demonstration Projects respectively during the immediately preceding 6 month period and, each Quarter, estimates indicating the apportionment of the expenditure of Contributions to R&D and Demonstration Projects for the upcoming Quarter, and
- financial reports on a yearly basis ending 30 June of each year, such financial reports to be audited annually.

38. Copies of some reports to ACALET and statements to Contributors have been provided illustrating the apportionment of the contributions which have been received by ANLEC, and applied towards the ANLEC Project. This apportionment reflects expenditure that may give rise to a notional deduction for the Contributors under Subdivision 355-D, and expenditure that will not.

39. The Funding Agreement has established a supervisory body known as the Programme Review Committee (**PRC**). The PRC consists of three members, one of which is nominated by ACALET. The PRC has a supervisory role in relation to reviewing:

- the progress of the ANLEC Project, including the activities of each research node

- the performance of the Research Programme
- the draft Annual Plan submitted for each Financial Year, and providing feedback on that Annual Plan to ANLEC
- and providing feedback to ANLEC on the Pro Forma Funding Agreement
- and providing feedback to ANLEC on the Pro Forma IP Deed Poll
- the implementation of the Annual Plan supporting the ANLEC Project, and
- the performance of ANLEC under the terms of the Funding Agreement.

40. Whilst the PRC has no decision making powers, it has power to consider changes to the funding principles under the Funding Agreement.

41. In addition to supporting the functioning of the PRC, ANLEC is required to gain ACALET's approval for both:

- the Research Programme that underpins the ANLEC Project, and
- the Annual Plan that underpins the ANLEC Project.

42. As discussed in paragraph 39, the PRC has a supervisory role in relation to the development of the pro-forma funding agreements and Intellectual Property (IP) deed polls which form the basis of the various Eligible Project Funding Agreements entered into between ANLEC and third party researchers. The various Eligible Projects supported by each Eligible Project Funding Agreement are the constituent parts of the ANLEC Project.

43. As discussed in paragraph 34, all funding provided by ACALET in accordance with the Funding Agreement must be used for the ANLEC Project. Further, the funds must be spent in accordance with the Annual Plan and associated Funding Principles and not paid to any other party. ACALET retains a power to direct ANLEC not to spend funds which have been paid over, but remain unspent by ANLEC at the point in time when ACALET so directs.

44. It is expected that the information detailed in the Annual Plan prepared by ANLEC will ultimately feed into the reports that ANLEC has agreed to provide to ACALET. This information will then feed into the reports which ACALET provides to its Contributors.

45. Under the terms of the Funding Agreement, ACALET may provide certain material to ANLEC for use in the ANLEC Project. This is referred to as 'ACALET Material'. ACALET may impose conditions and restrictions on the use of the ACALET Material, provided they are consistent with the Funding Agreement.

46. IP that is developed from the ANLEC Project is referred to as 'Agreement Material'. Under the Funding Agreement, ownership of any IP rights associated with the Agreement Material shall vest in ANLEC. However, in the event that the Agreement Material cannot be owned by ANLEC, then the Funding Agreement requires that ANLEC use reasonable endeavours to obtain licenses over the Agreement Material on behalf of ACALET and its Contributors.

47. The parties to the Funding Agreement recognise that third parties will bring pre-existing Material in the form of IP which will ultimately be utilised in the ANLEC Project. The Funding Agreement provides for ANLEC to grant licences to ACALET (and their Contributors) to allow these persons to utilise any pre-existing Material so as to enable ACALET to exploit the Agreement Material developed during the course of the ANLEC Project.

48. ANLEC is required to provide certain warranties in relation to pre-existing Material. For example, ANLEC is required to warrant that the use of that material by ACALET (or their Contributors) will not infringe the IP rights of any person.

49. As discussed in paragraph 46, where possible Agreement Material will be owned by ANLEC. Contributors will not own any assets acquired in the course of the ANLEC Project, nor will they be the holder of any depreciating assets under section 40-40 of the ITAA 1997. Further, by making contributions to the ACALET Program, the Contributors are not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities.

50. Under the terms of the Contribution Deed ACALET has agreed to supply all information that it has in relation to any R&D or demonstration projects to the Contributors. However, this is subject to the terms of any agreement that ACALET may have entered into.

51. Some contributions made by the Contributors to ACALET are also used by ACALET for management and administration activities in respect of the ANLEC Project.

52. Levies paid to ACALET by Contributors constitutes 'expenditure incurred' for the purposes of ascertaining entitlement to a notional deduction under section 355-205, or a general deduction under section 8-1. Levies paid by each Contributor to which this Ruling applies, for each relevant income year, are \$1,000 or more.

53. Contributions do not produce any enduring benefit or advantage to the Contributors, but rather are intended to assist them in marketing their product.

R&D activities

54. Low Emission Coal Technology (LECT) typically refers to one of the following technologies:

- Integrated Gasification Combined Cycle with Carbon Capture and Storage (IGCC with CCS), or

- Pulverized Coal (PC) combustion, either with Post Combustion Capture (PCC) or Oxy-Fuel.

55. LECT has not yet been widely deployed on a commercial scale. PC (without carbon capture) dominates both the world and Australian coal based power generation industries. The ANLEC Project has the primary objective of providing the data, knowledge and capability to allow rapid and low risk implementation of LECT with CCS under Australian conditions on a commercial scale.

56. Benefits of this R&D will include:

- reduced cost and time required for project developers to take a project to pre-FEED status
- reduced cost and time required in permitting of projects
- reduced financing risk through increased knowledge and data available to owners & bankers engineers.
- reduced capital and operating cost and increased operating flexibility through tailoring of plant specifically for Australian fuels, market requirements and environmental conditions
- reduced risks involved in using Australian fuels in commercial LECT systems, thereby supporting future marketability of those fuels
- improved plant reliability and availability, and
- evaluation of options for step changes in cost and efficiency from second generation technologies.

57. ANLEC will focus on accelerating the feedback between the early demonstration projects and the applied technology R&D, thereby mitigating risk and accelerating the technology development cycle.

58. The R&D will be conducted across the following program areas:

- (a) Capture
 - IGCC
 - Oxy Fuel
 - Post Combustion Capture
- (b) Geosequestration
- (c) Brown Coal
- (d) Economics, and
- (e) Alternatives and Fundamentals.

No research service provider or CRC contributions

59. Contributions are not expenditure incurred to a research service provider (**RSP**) within the meaning of the IR&D Act 1986, or a Cooperative Research Centre (**CRC**) under the Commonwealth CRC program.

Commonwealth funding

60. The Commonwealth has entered into a separate funding agreement with ANLEC in relation to the ANLEC Project. The terms on which the Commonwealth will fund ANLEC are broadly the same as those embodied in the Funding Agreement.

Ruling

R&D expenditure giving rise to a tax offset

61. For the years of income ending 30 June 2012 to 30 June 2017 inclusive (or equivalent substituted accounting periods), to the extent that a Contributor pays levies in an income year that:

- amount to \$1,000 or more
- are for R&D activities as defined in section 355-20, and
- represent expenditure arising under section 355-205

they will be entitled to a tax offset calculated in accordance with section 355-100. Further, subsection 355-210(2) will not preclude a notional deduction arising under section 305-205.¹

62. A notional deduction is not allowable under section 355-205 to a Contributor:

- for any part of the contributions incurred on activities that are not R&D activities, as defined in section 355-20
- for any part of the contributions incurred on R&D activities for which the Contributor is not registered under section 27A of the IR&D Act 1986 for each of the income years in question, or
- if the notional deductions used in calculating their entitlement to a tax offset under section 355-100 is less than \$20,000.

¹ Subdivision 355-F may prevent a notional deduction arising under section 355-205. As discussed in paragraphs 85 to 87, this Ruling does not consider the application of Subdivision 355-F to the scheme described in paragraphs 12 to 60.

63. The Commissioner acknowledges that any opinion formed about the R&D activities referred to in this Ruling can be overridden by Innovation Australia (the Board). Therefore, the Commissioner does not express an opinion about these activities and whether they are R&D activities as defined in section 355-20. This Ruling is made on the presumption (unless told otherwise by the Board) that the activities are R&D activities as defined under section 355-20.

Section 82KZMD of the ITAA 1936

64. Where expenditure is notionally deductible under section 355-205, and the R&D activities to which the expenditure relates are not carried out in the current income year, section 82KZMD of the ITAA 1936 applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

Clawback – Subdivision 355-G

65. Subdivision 355-G does not apply to any expenditure incurred by a Contributor if the requirements in section 355-440 are not met. Contributors are not recipients of any funds (or other form of recoupment):

- paid under the Commonwealth Funding Agreement, or
- from an Australian government agency, or a State/Territory body (STB) within the meaning of Division 1AB of Part III of the ITAA 1936.

66. As participation in the ANLEC Project does not result in a Contributor receiving any of these funds, they will not be required to pay extra income tax under section 355-435 in relation to this participation.

67. If a Contributor is in recipient of the funds referred to in paragraph 65, and wants to know whether Subdivision 355-G applies to them they should apply for a private ruling.

Section 8-1

68. For the years of income ending 30 June 2012 to 30 June 2017 inclusive (or equivalent substituted accounting periods), the portion of the levy paid by a Contributor to the ACALET Program, which does not qualify for a notional deduction under section 355-205, will be deductible under section 8-1.

Section 82KZMD of the ITAA 1936

69. Where expenditure deductible under section 8-1 relates to activities which are not carried out in the current income year, section 82KZMD of the ITAA 1936 applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

Commissioner of Taxation

19 December 2012

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Meaning of R&D activities and other terms

70. R&D activities are defined in section 355-20. This Ruling applies only to those Contributors who are correctly registered with Innovation Australia, so that the activities being undertaken in accordance with the Funding Agreement for the ANLEC Project are regarded as being 'R&D activities' undertaken by the Contributors.

71. A Contributor cannot rely on this Ruling if the Board determines that:

- a Contributor is not eligible for registration in relation to the activities which ANLEC conducts as part of the ANLEC Project, or
- the activities of the ANLEC Project do not constitute core R&D activities (within the meaning of section 355-25), or supporting R&D activities (within the meaning of section 355-30).

R&D Entities

72. R&D entities are defined in section 355-35 as:

355-35 R&D entities

- (1) Each of the following is an **R&D entity**:
 - (a) a body corporate incorporated under an *Australian law;
 - (b) a body corporate incorporated under a *foreign law that is an Australian resident.
- (2) A body corporate incorporated under a *foreign law that:
 - (a) is a resident of a foreign country for the purposes of an agreement in force between that country and Australia that:
 - (i) is a double tax agreement (as defined in Part X of the *Income Tax Assessment Act 1936*); and
 - (ii) includes a definition of **permanent establishment**; and
 - (b) carries on business in Australia through a permanent establishment (within the meaning of that definition) of the body corporate in Australia;

is an **R&D entity** to the extent that it carries on business through that permanent establishment.

- (3) However, an *exempt entity cannot be an **R&D entity**.

73. The class of persons to which this Ruling applies (Contributors) are R&D entities within the meaning of section 355-35. Therefore this requirement is satisfied for the class of persons to which this Ruling applies.

Entitlement to tax offset

74. For the purposes of this Ruling when calculating a Contributor's entitlement to an R&D tax offset it is necessary to first ascertain that they have notional deductions (for the purposes of Subdivision 355-C) for the year of income, that are at least \$20,000. This is not to say that a Contributor must make contributions to ACALET of \$20,000 each year. Rather, it is necessary that the R&D activities for which the Contributor is registered with Innovation Australia, result in them having notional deductions for the purposes of Subdivision 355-C that are at least \$20,000 (subject to any other relevant requirements in Division 355 being satisfied).

75. Where an R&D entity is entitled to deduct an amount under:

- section 355-205 (R&D expenditure)
- section 355-305 (decline in value of R&D assets)
- section 355-315 (balancing adjustment for R&D assets)
- section 355-480 (earlier year associate R&D expenditure)
- section 355-520 (decline in value of R&D partnership assets)
- section 355-525 (balancing adjustment for R&D partnership assets)
- section 355-580 (CRC contributions)

then that amount is used in calculating the R&D entity's entitlement to a tax offset, which is determined by reference to the tables contained in section 355-100.

When notional deductions for R&D expenditure arise

76. A tax offset will be available in a year of income under Subdivision 355-C to the extent that an R&D entity:

- incurs expenditure *on* one or more R&D activities (within the meaning of section 355-205) in the year of income
- is registered under section 27A of the IR&D Act 1986

- has notional deductions of at least \$20,000 for that year of income, and
- is entitled to those notional deductions, and is not precluded by any other provision of Division 355.

Whether the contributions are incurred 'on one or more *R&D activities'

77. Paragraph 355-205(1)(a) says that in order to deduct expenditure for an income year the expenditure needs to have been 'incurred on one or more *R&D activities'. The nature of the connection between the expenditure and the R&D activities expressed by the word 'on' in this context is governed by its place in the overall scheme of Division 355.

78. In Division 355, section 355-5 provides that the object of the Division concerns encouraging the conduct of particular R&D activities. Paragraph 355-205(1)(b) envisages that an R&D entity might incur expenditure within paragraph 355-205(1)(a), that is, incurring that expenditure 'on' an R&D activity, by incurring an amount to an 'associate' of theirs. That associate might be the entity which conducts the R&D activity, or it might, in turn, pay its employees, or an agent, or an independent contractor, to conduct this activity. The requirement that the expenditure be linked to the conduct of particular R&D activities is also found in subsection 355-210(1), concerning whether the expenditure coming within paragraph 355-205(1)(a) has also been incurred on activities which have been 'conducted for' the R&D entity (see, paragraph 355-210(1)(a)).

79. Also in Division 355, section 355-110 provides for the spreading of an R&D entity's deductions under section 355-205 or section 355-480, where the prepaid expenditure rules in Subdivision H of Division 3 of Part III of the ITAA 1936 apply. Section 355-110 thus contemplates that there may be expenditure which comes within paragraph 355-205(1)(a), where there is a lapse in time between when that expenditure is incurred on particular R&D activities, and when those activities begin to be conducted.

80. The fact that the expenditure in question might be incurred to an intermediary, or that there might be a gap in time between the expenditure being incurred and when the R&D activities begin, therefore will not in themselves, mean that the expenditure fails the requirement of needing to have been 'incurred on one or more R&D activities'. On the other hand, having regard to the object of Division 355, expenditure that is 'on' an activity which is not an R&D activity, where that expenditure is not integral to the conduct of any R&D activity, cannot be said to be sufficiently connected to the conduct of any R&D activity in a way which would bring it within paragraph 355-205(1)(a).

81. Factors to consider in determining whether this sufficient connection exists include:

- the terms and conditions of any contract under which the expenditure in question has been incurred
- how those terms and conditions relate to the conduct of any R&D activities
- how many intermediaries there might be between the R&D entity and this conduct
- any lapse in time between when the expenditure is incurred and when the R&D activities begin to be conducted, and
- whether the expenditure can reasonably be expected to produce results 'for' the R&D entity incurring it, from the R&D activities the expenditure is said to have been incurred on.

Registration under section 27A of the IR&D Act 1986

82. In accordance with subparagraph 355-205(1)(a)(i), an R&D entity's entitlement to a notional deduction in income year, will only arise if (amongst other requirements) it is registered (for the activities to which the expenditure relates) under section 27A of the IR&D Act 1986.

83. The class of entities to which this Ruling applies comprise companies registered in relation to specific R&D activities in accordance with the requirements of subparagraph 355-205(1)(a)(i). Therefore, this requirement is satisfied for the class of entities to which this Ruling applies.

Notional deductions of at least \$20,000

84. The class of entities that this Ruling applies to comprises R&D entities with notional deductions for the purposes of calculating entitlement to a tax offset under section 355-100 of at least \$20,000. Therefore, the third requirement is satisfied.

Preclusion by other provisions

85. Subsection 355-205(2) provides that a notional deduction arising under subsection 355-205(1) will be subject to the effect of:

- section 355-255 (excluded expenditure)
- Subdivision 355-F (integrity rules), and
- subsection 355-580(3) (CRC contributions).

Excluded expenditure

86. Section 355-255 excludes certain types of expenditure from giving rise to a notional deduction under section 355-205, and subsequent inclusion in the calculation of any entitlement to a tax offset under section 355-100. The contributions to the ACALET Program do not result in Contributors having any of the excluded expenditure types in section 355-255, for the following reasons:

- Contributors neither acquire, construct, alter, nor improve any building etc as a result of making contributions
- Contributors are not the holder of any Division 40 depreciating assets under section 40-40 as a result of their contributions to the ACALET Program, and therefore the expenditure is not for the acquisition or construction, nor does it otherwise form part of the cost of such depreciating assets
- contributions are not interest or an amount in the nature of interest incurred in the financing of R&D activities, and
- the Contributor is not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities.

Integrity rules

87. Subdivision 355-F sets out various rules which are intended to preserve the integrity and operation of the R&D tax incentive. Paragraph 3.155 of the Explanatory Memorandum that accompanied the Tax Laws Amendment (Research and Development) Act 2011 (**EM**) explains that Subdivision 355-F was intended to preserve (in a corresponding way), the integrity provisions in the existing R&D provisions.

88. This Ruling does not consider whether any of the integrity rules identified in Subdivision 355-F operate in such a way as to either prevent (or alter) a notional deduction that would otherwise arise under subsection 355-205(1).

89. A Contributor who wants to ensure that Subdivision 355-F does not have application to their circumstances should apply for a private ruling.

CRC contributions

90. As identified in paragraph 59, contributions are not being paid to any entity that is part of the Commonwealth government's CRC program.

R&D partnerships

91. Given that there is no partnership between Contributors; Subdivision 355-J does not apply to this Ruling.

Conditions for R&D activities

92. A Contributor's entitlement to a notional deduction under subsection 355-205(1) is subject to section 355-210 being satisfied. Section 355-210 provides specific conditions that must be satisfied before an activity will be regarded as an R&D activity. For the purposes of this Ruling those conditions are:

- that the R&D activities that give rise to the expenditure are being conducted 'for' the R&D entity (paragraph 355-210(1)(a)), and
- the R&D activities are not being conducted, to a significant extent, for one or more other entities not covered by any paragraph of subsection 355-210(1).

93. Whether R&D activities are to be carried out 'for' a Contributor as required by paragraph 355-210(1)(a), and not 'to a significant extent' for any other persons besides the Contributors, as provided by subsection 355-210(2), is considered in paragraphs 94 to 110 of this Ruling.

R&D activities conducted 'for' the R&D entity and not 'to a significant extent' for other entities

94. Entitlement to a notional deduction under section 355-205 for the payment of levies to ACALET will only arise if that expenditure is incurred on R&D activities, and those R&D activities are conducted 'for' the R&D entity. Further, the R&D activities which give rise to any notional deduction under section 355-205 must not be 'conducted, to a significant extent' for any other entity which does not satisfy the qualifying condition in paragraph 355-210(1)(a).²

95. In explaining when expenditure on R&D will give rise to a notional deduction, the EM explains (at paragraphs 3.52 – 3.55):

Generally, an R&D entity is only entitled to a tax deduction in relation to R&D activities conducted for the entity (whether by the R&D entity for itself or by another entity for it). Also, an entity cannot deduct its expenditure on R&D activities if it conducts those activities to a significant extent for another entity.

² Paragraphs 355-210(1)(b)-(e) consider various circumstances where the R&D activities are being conducted for entities under other specific qualifying conditions. This Ruling only applies to R&D activities which satisfy the condition specified in paragraph 355-210(1)(a).

This retains a key rule from the existing law commonly known as the 'on own behalf' rule. This rule is intended to limit eligibility for a notional R&D deduction to where an R&D entity is the major benefactor from the expenditure it incurs on the R&D activities. In certain situations, the rule also prevents duplication of claims by different R&D entities.

Determining the major benefactor of expenditure on R&D activities involves examining the extent to which R&D activities are carried out for the R&D entity compared to the extent to which they are carried out for any other entity. This is tested by weighing up three key criteria, namely who:

- 'effectively owns' the know-how, intellectual property or other similar results arising from the R&D entity's expenditure on the R&D activities;
- has appropriate control over the conduct of the R&D activities; and
- bears the financial burden of carrying out the R&D activities.

In short, the question of whether an R&D activity is conducted for an R&D entity is a question of fact, determined by whether the activity is conducted in substance to provide the majority of knowledge benefits resulting from the activity, such as access to intellectual property, to this entity.

Whether an R&D entity has effective ownership involves reviewing all the circumstances surrounding the conduct of the relevant activities and the ownership and control of, and/or ability to utilise, the intellectual property or similar results obtained from the expenditure on the R&D activities.

96. These three key criteria apply then to two of the conditions in section 355-210. The first condition concerns whether, in a positive sense, the R&D activities in question have been conducted 'for' the R&D entity (paragraph 355-210(1)(a)). The second concerns whether, in a negative sense, those R&D activities have been conducted 'to a significant extent, 'for one or more other entities not covered by any paragraph of subsection (1)' (subsection 355-210(2)). Applying these key criteria to a particular case requires weighing them up against the relevant facts and circumstances of that case.

Effective ownership

97. A company effectively owning results of the relevant R&D activities is the first identifying criterion in determining whether the R&D activities are being carried out for that company. However, it is recognised that this does not necessarily require that the company must be the proprietor of a piece of IP, as formal regimes of IP may not be available to protect the results. Further, it is possible that the formal owner of the IP may hold it on such terms that the company has all advantages of ownership.

98. If a number of companies fund an R&D project together on their behalf, it is necessary that each must have a proper and effective interest in the R&D results.

99. ACALET uses levies paid by Contributors to fund the activities of ANLEC, or more particularly, the ANLEC Project. Any IP generated as a result of the ANLEC Project will not be legally owned by the Contributors. However, we are more concerned with effective ownership of the results of the R&D projects and whether the benefits obtained by the Contributors are such that they have an interest in the results of the ANLEC Project that is commensurate with their contributions.

100. The Contribution Deed between ACALET and the Contributor promises 'that the results of the research and development will be made available for the benefit of the operator to the extent possible under the terms of the agreements'.

101. In order to determine whether the Contributors' interests in the results of the R&D activities funded by their levies are commensurate with their contributions, it is necessary to consider the benefits that flow from the expenditure to the Contributors.

102. An examination of the benefits that Contributors are expected to gain and their individual interests in the results of the R&D activities conducted in connection with the scheme to which this Ruling applies, in comparison to their relevant expenditure, leads to the conclusion that the expenditure is commensurate with the benefits to be gained.

Control

103. The second identifying criterion is the nature and extent of control that the Contributors have over the R&D activities. It is considered that the Contributors, as a group, sufficiently control the R&D activities that they have contracted ACALET to provide. The Contribution Deed has set the parameters for the R&D to be undertaken and the underlying philosophies which ACALET is bound to follow. The Contributors have effective legal control, as they have the ability to compel ACALET to perform in accordance with the Contribution Deed. The manner in which the program is executed also supports the conclusion that the Contributors have sufficient control over the R&D activities.

Financial risk

104. The final identifying criterion is the degree of financial risk that Contributors are assuming when the R&D activities are undertaken. In accordance with the Contribution Deed, Contributors pay contributions which are calculated at a rate of up to \$0.20 per tonne of coal produced over the term of the agreement. Payments are required on a quarterly basis. The Contribution Deed makes it clear that these contributions become the property of ACALET. These contributions cannot be refunded to the Contributors.

105. As Contributors pay non-refundable levies, they bear the financial risk associated with the R&D activities undertaken.

Summary

106. The terms of the Contribution Deed show that contributions will be applied exclusively for R&D, demonstration projects and also for management and administration expenses relating to the above. The Funding Agreement specifies contributions can only be used for the purposes of the ANLEC Project. Some of the contributions will therefore be directed towards R&D activities identified above.

107. Similar to other parties to the ANLEC Project, Contributors benefit from the results of the R&D activities, including receiving final reports. They also have the same rights in relation to the use of the ANLEC Project's IP for internal purposes as other parties to the ANLEC Project. This shows there is a practical link between the expenditure and the activities and the results to be produced from the activities.

108. Therefore, this illustrates that there is a sufficiently close connection between the portion of contributions used to fund the carrying on of R&D activities for the ANLEC Project, such that this expenditure qualifies as being 'for' the activities identified as R&D activities. The extent to which this is so will depend on the fairness and reasonableness of the apportionment methodology used. As discussed in paragraph 80, the fact that payments are made to an intermediary does not preclude those payments from being on particular R&D activities.

109. An examination of the benefits that Contributors are expected to gain and their individual interests in the results of the R&D activities conducted in connection with the scheme to which this Ruling applies, in comparison to their relevant expenditure, leads to the conclusion that the expenditure is commensurate with the benefits to be gained.

110. Contributions incurred by Contributors to ACALET are expenditures on conducting R&D activities 'for' them, for the purposes of determining whether the Contributors are entitled to deduct amounts under section 355-205. Subsection 355-210(2) will not preclude any entitlement to a notional deduction on the basis that the R&D activity is being conducted to a significant extent for another entity, which itself does not satisfy section 355-210.

Subdivision 355-G – Clawback

111. Section 355-435 requires that an entity pay extra income tax when the requirements of section 355-440 and section 355-445 are met. The condition identified in section 355-440 requires that the entity receive (or becomes entitled to receive) a recoupment from:

- an Australian government agency, or

- an STB (as defined in Division 1AB of Part III of the ITAA 1936)

otherwise than under the CRC program.

112. Under section 355-445, the entitlement to a recoupment referred to in paragraph 111 must then be:

- received during an income year (referred to as the trigger year)
- be incurred on or in relation to certain activities, or
- require that expenditure (referred to as project expenditure), to have been or to be incurred on certain activities.

113. Commonwealth funding is a significant part of the ANLEC Project, and ACALET has certain rights under the Funding Agreement which are dependant upon the Commonwealth complying with its own funding obligations in respect of the ANLEC Project. However, both ACALET and the Commonwealth's funds can only be utilised by ANLEC in accordance with the terms of the relevant funding agreement. The Commonwealth funding cannot be utilised or returned to any Contributor.

114. ANLEC is the relevant entity which incurs the expenditure referred to in section 355-445.

115. Any receipt of the Commonwealth funding by a Contributor in relation to the ANLEC Project is outside the scope of this Ruling. If a Contributor in this position wants to know whether Subdivision 355-G applies to them they should apply for a private ruling.

Section 8-1 – general deduction

Entitlement to a deduction for payments made under the Contribution Deed which are not payments that can be notionally deducted under section 355-205

116. To the extent that a payment made by a Contributor is not expenditure which can be notionally deducted under section 305-205, it may nevertheless be deductible under section 8-1. To be entitled to a deduction under section 8-1, a Contributor will need to satisfy subsection 8-1(1), and also not be precluded by any part of subsection 8-1(2).

117. Generally, this means that the payment will need to be:

- capable of being characterised as a 'working or operating expense' of the business of the Contributor, and
- necessarily incurred in carrying on the business of the Contributor.

Taxation Ruling TR 95/1³

118. Taxation Ruling TR 95/1 considers whether advertising costs associated with opposing legislation will be a deductible expense. TR 95/1 was issued as a result of the decision in *Federal Commissioner of Taxation v. Rothmans of Pall Mall (Aust) Ltd* (1992) 37 FCR 582; 92 ATC 4508; (1992) 23 ATR 620 (*Rothmans*).

119. The decision in *Rothmans* provides some assistance in determining a Contributor's entitlement to a deduction under the scheme set out in this Ruling. *Rothmans* concerned a claim for a deduction by a member of the Tobacco Institute of Australia (the Institute). That member claimed their contribution to the Institute as a deduction from their assessable income. At paragraph 10 of TR 95/1, the Commissioner notes that:

The Court decided that the nature of the expenditure incurred by the company was, *in the present commercial environment, an ongoing part of the circumstances in which companies carry on business. Accordingly, it was incidental to the carrying on of its business and did not involve the acquisition of an enduring asset.* Lockhart J relied upon the decisions of the High Court in *FC of T v. Snowden & Willson Pty Ltd* (1958) 99 CLR 431 and of the Federal Court in *Magna Alloys and Research Pty Ltd v. FC of T* 80 ATC 4542; (1980) 11 ATR 276. His Honour found that the company was not seeking to maintain or preserve an existing capital asset by paying the levy to the Tobacco Institute. [emphasis added]

120. The principle established in *Rothmans* can be extended to include any portion of the levy payment (that is not eligible to be notionally deducted under section 355-205), which can be properly characterised as being incidental to the Contributor's business.

121. Where a Contributor makes a payment to ACALET, which enables it to promote its involvement with the ANLEC Project, it will be appropriate to characterise a portion of that payment as being in the nature of a marketing expense. The contributions are regular payments that do not produce any enduring benefit or advantage to the Contributors, but rather are intended to assist them in marketing their product.

122. Accordingly, in these circumstances, the payment will be deductible under subsection 8-1(1), and will not be precluded by any part of subsection 8-1(2).

³ Taxation Ruling TR 95/1 Income tax: deductibility of advertising that opposes the passing of legislation.

Prepayments

123. The timing of any entitlement to a tax offset available under section 355-100, or a deduction under section 8-1 can be affected by the prepayment rules. Section 82KZMA of the ITAA 1936 sets the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income (the expenditure year), if:

- apart from those sections, a deduction under section 8-1, or section 355-205 (R&D expenditure) or section 355-480 (earlier year associate R&D expenditure), in respect of the expenditure, would be allowable from the Contributor's assessable income, and
- the requirements in subsections 82KZMA(2) to (5) of the ITAA 1936 are met.

124. As discussed above, the requirements of section 355-205 (R&D expenditure) will be met for expenditure incurred on R&D activities, and those for section 8-1 will be met for any remaining expenditure incurred by Contributors to ACALET under the Contribution Deed. Whether the requirements of subsections 82KZMA(2) to (5) of the ITAA 1936 are satisfied also needs to be considered.

Whether subsections 82KZMA(2) to (5) are satisfied

125. Subsections 82KZMA(2) to (5) of the ITAA 1936 are satisfied for the reasons outlined below:

- subsections 82KZMA(2) will be satisfied irrespective of whether the Contributors are carrying on a business or not⁴
- similarly, paragraph 82KZMA(3)(a) will be satisfied irrespective of whether the expenditure is incurred in carrying on a business or otherwise than in carrying on a business
- the expenditure is incurred under an agreement as required by paragraph 82KZMA(3)(b)
- for reasons discussed in paragraph 121 of this Ruling, the expenditure is not capital in nature, and therefore is not excluded expenditure⁵ as required by subsection 82KZMA(4). Further, none of the other excluded expenditure categories apply to the contributions made by the Contributors, and

⁴ Paragraph 82KZMA(2)(a) requires that the taxpayer must either be carrying on a business, or be a taxpayer that is not an individual and that does not carry on a business. Further, taxpayers to whom paragraph 82KZMA(2)(b) applies are outside the class of entities covered by this Ruling.

⁵ Excluded expenditure, as defined in subsection 82KZL(1) to mean:

- in accordance with subsection 82KZMA(5), the expenditure is not a pre-RBT obligation.⁶

126. Under paragraph 82KZMA(3)(c), the expenditure must also be in return for the doing of a thing under the agreement that is not to be wholly done within the expenditure year. The expenditure in question is, and will continue to be, incurred on an ongoing basis over the course of several years. The application of the expenditure and the means by which it delivers benefits to the Contributors depends on the complex interaction between several agreements, none of which precisely prescribe when various activities are to start being done, and when they are to stop being done.

127. The substance of these agreements however, is that the expenditure will typically relate to activities to be carried out at some future time, on the basis that ANLEC requires funds in advance in order to see that the activities which are the subject of the ANLEC Project are begun.

128. In respect of expenditure incurred over any one year it will generally not be possible to conclude therefore that it has all been incurred in return for doing things (the activities) that are all to be completed by the end of that year. Consistent with the proposition that contributions will be applied progressively over the life of the ANLEC Project to carry out budgeted activities on behalf of the Contributors is the notion that each contribution is intended to fund only so much of these activities at any one time.

an amount of expenditure:

- (a) less than \$1,000; or
- (b) required to be incurred by a law, or by an order of a court, of the Commonwealth, a State or a Territory; or
- (c) under a contract of services : or
- (d) to the extent that it is of a capital, private or domestic nature; or
- (e) that has been or is incurred after 21 September 1999 by a general insurance company in connection with the issue of a general insurance policy and was related or relates to the gross premiums derived by the company in respect of the policy; or
- (f) that has been or is incurred after 21 September 1999 by a general insurance company in payment of reinsurance premiums in respect of the reinsurance of risks covered by general insurance policies, other than reinsurance premiums that were or are paid in respect of a particular class of insurance business where, under the contract of reinsurance, the reinsurer agrees, in respect of a loss incurred by the company that is covered by the relevant policy, to pay only some or all of the excess over an agreed amount.

⁶ Pre-RBT obligation means a contractual obligation that:

- (a) exists under an agreement at or before 11.45 am (by legal time in the Australian Capital Territory) on 21 September 1999; and
- (b) requires the payment of an amount for the doing of a thing under the agreement; and
- (c) requires the payment to be made before the doing of the thing; and
- (d) cannot be escaped by unilateral action by the party bound by the obligation to make the payment.

129. Accordingly, the condition in paragraph 82KZMA(3)(c) will also be satisfied. Identification of when the various activities are to start and stop is best done by reference to the underlying planning and budgetary documentation that guides ANLEC's actions. Determination of these stop and start times will necessarily, in the circumstances, be one of reasonable estimation, rather than something that occurs with absolute precision.

Amount and timing of deduction

130. In accordance with section 82KZMD(2) of the ITAA 1936, for each year of income containing all or part of the eligible service period for the expenditure, the taxpayer may deduct the amount under section 8-1, or notionally deduct the amount under section 355-205 by applying this formula:

$$\text{Expenditure} \times \frac{\text{number of days in the eligible service period for the year of income}}{\text{total number of days of eligible service period}}$$

131. The eligible service period in relation to an amount of expenditure incurred under an agreement, means the period from the beginning of:

- (a) the day or the first day on which the thing to be done under the agreement in return for the amount of expenditure is required, or permitted as the case may be to commence being done, or
- (b) if the expenditure is incurred on a later date – the day on which the expenditure is incurred,

until the end of:

- (c) the day, or the last day, on which the thing to be done under the agreement in return for the amount of expenditure is required or permitted as the case may be to cease being done, or
- (d) if that day or the last day ends more than 10 years after the beginning of the period – 10 years after the beginning of the period.

132. Relevant to the task of determining the eligible service period are the Contribution Deed, the Funding Agreement, and any other agreements entered into for the purposes of the ANLEC Project. In addition, financial reports, annual reports and annual budgets provided to ACALET for the purposes of the ANLEC Project will also be of assistance.

133. There is an inherent or expected degree of imprecision when applying the calculation required under section 82KZMD. As discussed in paragraph 129, with reference to ANLEC's underlying planning and budgetary documentation which guide its actions, it should be possible to calculate the amount identified in section 82KZMD with reasonable estimation.

134. Analysis of the ANLEC Project's spending to date in conjunction with the budget details for the planned spending should provide a suitable indicator as to how much of the contributions paid to date have actually been applied to the activities of the ANLEC Project, and what the typical 'lag' is in this respect, so as to produce a broad, but still reasonable reflection of the extent to which each quarter's sum of contributions relates to activities to be performed in the future.

135. Note that in circumstances in which the last day of the eligible service period would exceed 10 years after the eligible period's start date, the eligible service period is limited to a period of 10 years. Refer to the definition of 'eligible service period' in subsection 83KZL(1) of the ITAA 1936.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2009/45; CR 2010/44;
CR 2012/82; TR 95/1; TR 2006/10

Subject references:

- on own behalf
- research and development tax offsets

Legislative references:

- ITAA 1936 82KZL
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- ITAA 1936 82KZMA(2)
- ITAA 1936 82KZMA(3)(a)
- ITAA 1936 82KZMA(3)(b)
- ITAA 1936 82KZMA(3)(c)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMA(5)
- ITAA 1936 82KZMD
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- ITAA 1997 Div 355
- ITAA 1997 355-20
- ITAA 1997 355-25
- ITAA 1997 355-30
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- Explanatory Memorandum to the Tax Laws Amendment (Research and Development) Bill 2010

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