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Ruling Compendium – TR 2013/3

This is a compendium of responses to the issues raised by external parties to draft TR2012/D6 – *Income tax: research and development tax offsets: feedstock adjustments*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	The Ruling does not clarify the types of activities a feedstock adjustment is required for, and fails to address the meaning of the term 'feedstock', concerning whether one-off production is covered.	The feedstock provisions do not contain any exclusions or exemptions for any specific R&D activities or industries. This is now addressed in paragraph 8. The words in paragraph 355-465(1)(a) 'in producing one or more tangible products' are clear that not just mass production is meant to be covered; see also paragraph 3.148 of the Explanatory Memorandum to Tax Laws Amendment (Research & Development) Bill 2010 (refer footnote 9 and paragraph 131). The term 'feedstock' is used as a label and any ordinary meaning for it does not govern the meaning of the expressions in which it appears. (see footnote 74).
2	The Ruling is not clear on when an R&D entity 'obtains' a tax offset for the purposes of the 2 nd condition in paragraph 355-465(1)(b).	Paragraphs 155 and 160 have been changed to clarify that 'obtains' in the 2 nd condition refers to a Division 355 tax offset having been allowed in relation to the relevant expenditure.
3	The Ruling does not clarify what the result is where there is no feedstock revenue (for example for lost or wasted product).	This was addressed at paragraphs 6 and 80 (Example 2) of the draft Ruling. The point that if there is nil feedstock revenue then there will be a nil feedstock adjustment, has now been highlighted as a standalone point at

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		paragraphs 6 and 236.
4	A discussion on the overall treatment of feedstock expenditure under Division 355 would be useful. For example, it would be helpful to discuss the necessity to include the feedstock expenditure in calculating the value of notional deductions for the tax offset.	Paragraph 10 now deals with all the elements of the 1 st condition. Changes have also been made to paragraphs 5 and 6 to clarify the impact of the second condition, specifically that a tax offset must have been obtained in relation to specific types of notional deductions, for Subdivision 355-H to have effect.
5	A definition of feedstock expenditure is required.	Feedstock expenditure is not used in the legislation or in the ruling. The legislation refers to expenditure in acquiring or producing feedstock inputs (which is defined in paragraph 9). However, a definition for 'feedstock input expenditure' has been included in paragraph 9 as this expression is used in the approved form, <i>Research and development tax incentive schedule</i> .
6	The definition feedstock inputs differs from the legislation	The feedstock inputs definition in paragraph 9 has been changed to remove 'used'
7	Goods or materials that are consumed during R&D activities, or do not form part of the tangible product produced, should be clearly identified as not being feedstock inputs.	Disagree. The 1 st condition neither expressly nor impliedly excludes such items. All goods or materials that are transformed or processed 'in producing' one or more tangible products are included, where this occurs during R&D activities. A footnote to the definition of feedstock inputs in paragraph 9 of the Ruling has been made to clarify this point stating that feedstock inputs are not limited to goods or materials that will form part of the final tangible product. Further guidance with respect to this issue will be considered for the inclusion in the program of future rulings and other guidance materials.

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8	Paragraph 69 should acknowledge the cost of producing the feedstock output will never be the same as the amounts referred to in subsection 355-465(2).	Paragraph 73 now acknowledges that in most cases the two amounts will not be the same.
9	Clarification is required of: • what is a multi-stage production process, given it is not a concept in the legislation and • the impact on the feedstock adjustment calculation, particularly where activities are non-sequential.	The discussion on multi-stage production activities is included to highlight that where a good or material is produced by the R&D entity and then relevantly transformed or processed within the 1st condition, it is the total cost of that production that falls within that condition. Whether or not all of that expenditure is then relevant to the calculation of any subsequent feedstock adjustment will depend on how much of has been claimed by the R&D entity (that is, how much of it falls within the 2nd condition). New Example 4 has been included in the Ruling to further explain these points.
10	Paragraphs 15-18 (1st condition) It would be unusual in practice to be able to identify costs associated with ordering raw materials as they are akin to overheads and may only have a limited nexus with the acquisition.	Paragraphs 15 to 18 do not prescribe what expenditure should be claimed as a notional deduction. It is only the expenditure that is claimed as a notional deduction which is recognised as one of the alternative amounts on which the feedstock adjustment might be based. Paragraphs 143 to 159 provide a discussion on the importance of the interaction between the 1st and 2nd conditions for a feedstock adjustment, and this is now further illustrated by new Example 4. The R&D entity's assessment of what notional deductions it is entitled to will affect the level of complexity surrounding any calculations of feedstock adjustment
11	The views expressed on the 1st condition are wrong at law. The 1st condition has been interpreted in the widest possible	The alternative view was considered and recognised as an alternative view in the draft ruling and for the reasons there identified, not considered to be the

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	way and inconsistently with Treasury comments during the consultation on the draft legislation.	correct view. The general concessional nature of Division 355 does not override the task of construing Subdivision 355-H by beginning with its text. 'Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of the legislation is the surest guide to legislative intention. The meaning of the text may require consideration of the context, which includes the general purpose and policy of a provision, in particular the mischief it is seeking to remedy', per Hayne, Heydon, Crennan and Kiefel JJ in <i>Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue (NT)</i> [2009] HCA 41 at [47]. The approach to the 1st condition has followed accepted principles of statutory interpretation. The argument that a narrower view of Subdivision 355-H should be adopted is not considered to pay sufficient attention to its purpose and context, and importantly, the mischief it is aimed at (refer in particular to paragraphs 164 to 171 of the Ruling). A copy of the draft Ruling was provided to Treasury and no adverse comments have been received.
12	Examples should be included of: - the range and types of expenditure that may or may not form part of expenditure on feedstock inputs - examples of non-manufacturing scenarios - requirement to claim feedstock inputs - acceptable methods for tracking quantities of feedstock	The types of expenditure that come within the 1st condition will depend on the circumstances in each case. No single listing of expenditure that will always be included can be provided. No new Industry specific examples have been included as no details were given in any comments received of how the principles identified in the draft Ruling needed modification or amplification in relation to any industry. Example 3 illustrates that acceptable methods for tracking quantities of feedstock outputs through to associated marketable products will depend on

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	outputs through to associated marketable products	the circumstances of each case, and that no one universal method necessarily exists. Advice on specific industries or circumstances can be obtained by way of class rulings or private binding rulings.
13	Paragraph 38 and 187 is not clear on whether the terms transformed and consumed are mutually exclusive.	Paragraph 42 now clarifies 'consumed' refers to a feedstock output ceasing to exist, and hence, not capable of becoming a transformed feedstock output.
14	More guidance is required on: • what is a reasonable basis for determining the lesser amount in subsection 355-465(2), and whether an R&D entity can choose to not calculate the feedstock revenue by assuming this will be higher than the feedstock expenditure • what is an acceptable level of aggregation of feedstock outputs • a reasonable methodology as an alternative to the formal adoption of accounting standards in determining a method for determining the relevant cost of producing the feedstock output or marketable product in section 355-470. • what constitutes reasonable attribution. Would the application of AASB concepts be acceptable?	Examples 1 and 3 of the Ruling provide some guidance on what is a reasonable basis, as does paragraph 46 in relation to relying on established facts to support the decision. The R&D entity's obligation is only to show the basis for that decision is a proper inference and more than mere speculation. Paragraph 46 makes a clear statement that an assumption or guesswork will be insufficient, and a proper inference is required based in fact. It is acknowledged however, that in many cases deciding, on the basis of the overall financial performance for particular products, that feedstock revenue for them will not be the relevant lesser amount will be a rational and cautious decision. Paragraph 62 sets out the factors relevant to whether an aggregation would be appropriate. Example 2 also provides an example of where aggregation is appropriate. The Ruling does not direct that the AASB standards apply but rather, indicates that the concepts in AASB102 should be considered in applying a systematic allocation of expenses for the purposes of Subdivision 355-H. Paragraph 75 provides that the internal cost accounting methods are acceptable where they are based on some type of systematic allocation and provide a rational and consistent basis for the attribution of notional deductions.

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15	Paragraph 81 – arguably no feedstock adjustment is required for the product that was discarded, as there was no supply or application to own use.	Agreed in part. A footnote has been added to the relevant paragraph (now paragraph 85), acknowledging whether the discarding of certain items amounts to a supply to another entity, or application to the R&D entity's own use, depends on the facts. It also acknowledges that whether or not a trigger condition is met, or simply that there is no feedstock revenue, the practical outcome is the same, that is, no feedstock adjustment will arise.
16	Paragraph 35 offers a contrary view to the draft ATOID provided to the National Reference Group.	The ATO Interpretative Decision in question has since been published as ATO ID 2012/89. Qualifications have been added to paragraphs 8 and 202 and a footnote has been added to the relevant paragraph (now paragraph 39), pointing out that where the use in question does not concern decline in value notional deductions within subparagraph 355-465(1)(b)(iii), then no feedstock adjustment will arise; it is only where use of the asset in question comes within the 2 nd condition that such use can trigger a feedstock adjustment.
17	The alternative views do not form part of the ruling	Alternative views are not ruled upon but form part of the discussion and reasoning in the explanation of the Commissioners view.
18	The new provisions: - are exceedingly complex and require legislative change to allow entities to exclude the expenditure of a type referred to in paragraph 355-465 (1)(b). - result in a significant administration burden to accurately cost the item for the purposes of the first condition even with the reasonable attribution. - by referring to the term 'supply' in the trigger condition,	This is a comment on the policy and structure of the legislation, which has been referred to Treasury and the Department of Industry, Innovation, Science, Research and Tertiary Education for their consideration. It is only necessary to determine the costs to the extent they have been notionally deducted as part of working out the tax offset claimed. Records and working papers will need to be kept with the possibility in mind, that where the 1st and 2nd conditions are met, then subsequent feedstock adjustments may occur.

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	create undue administrative burdens on companies to track feedstock outputs over what could be significant periods.	
19	The ruling should clearly address the operation of section 355-715 and situations where it does not prevent an R&D entity claiming particular expenditure as an actual deduction under, for example, section 8-1.	During consultation on the content of the draft ruling the interaction between section 355-715 and Subdivision 355-H was not identified as being relevant. However, a new Example 4 has been included in the ruling to highlight this point and the interaction with section 8-1.
20	The ruling should include a detailed discussion on: - the meaning of processing and transformation - the meaning of tangible products including whether electricity would be a tangible product - the meaning of goods or materials – would livestock/growing plants/microbes be considered to be a good or materials	These issues were not identified in the initial consultation and are beyond the scope of this ruling. They may be considered in the development of the program for future rulings and other guidance material.

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21	Subparagraph 355-465(1)(b)(iii) implies that the company should have claimed tax offsets for the decline in value of assets in acquiring or producing the feedstock inputs to be used in R&D activities.	This is not a comment on the Ruling, but on a particular provision. Subparagraph 355-465(1)(b)(iii) contemplates that there may be use of a depreciating asset in acquiring or producing feedstock inputs and caters for that possibility by including it in the 2nd condition. However, it does not direct that deduction will give rise to a tax offset. Rather it is for the R&D entity to determine whether there is a relevant nexus between the use of the asset and the R&D activities in question.
22	No comment is made with respect to prototypes and demonstration models: - confirm that the feedstock provisions do not apply to a prototype for which a decline in value is claimed. - discuss the scenario where that prototype or demonstration model is not a marketable product. - if the items are not supplied or held for future sale what is the treatment?	The discussion on prototypes is beyond the scope of this ruling as identified during the consultation process. However, some comments appear to assume the term 'marketable product' takes on some ordinary meaning, rather than recognising the term as a label in the legislation for the combined terms ' feedstock output' or 'transformed feedstock output' (refer footnote 74). Where a prototype or demonstration model is not a feedstock output or transformed feedstock output however, then the feedstock provisions will not apply. This follows from a plain reading of paragraph 355-465(1)(c).
23	The interaction between Subdivisions 355-H and 355-G has not been addressed.	The interaction between Subdivisions 355-H and 355-G is beyond the scope of this Ruling. This issue will be considered for the inclusion in the program of future rulings and other guidance materials, once further details have been gathered of the specific situations in which this interaction is considered to occur.