CR 2010/44 - Income tax: research and development: membership funding for the ACA Low Emissions Technologies Program

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Class Ruling

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

Contents Para

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 provisions 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 73B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 73C of the ITAA 1936;
- section 73L of the ITAA 1936;
- section 82KZL of the ITAA 1936;
- section 82KZMA of the ITAA 1936;
- section 82KZMD of the ITAA 1936; and
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies comprises 'eligible companies', as defined by subsection 73B(1), who are liable for levy contributions under the ACA Low Emissions Technologies Program, and who:

- are registered for each of the relevant years of income with Innovation Australia, in accordance with subsection 73B(10) of the ITAA 1936;
- have an aggregate research and development amount as defined in subsection 73B(1) of the ITAA 1936 that exceeds $20,000; and
- are not a small business entity as defined in section 328-110 of the ITAA 1997.

4. In this ruling the term 'contributing companies' is used to refer to these companies that are ultimately obliged to pay these 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'/'contributor(s)' where no separate 'mine owner(s)' are identified in the Contribution Deed.

5. This Ruling **does not apply** to eligible companies that are not registered for the relevant years of income with Innovation Australia. The publication of this Ruling does not relieve companies making ACALET contributions of the obligation to make separate applications for registration of their activities under section 39J of the *Industry Research and Development 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 Callide Oxyfuel Project and management and administration expenses in respect of this research and development and demonstration project. 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).

7. 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 16 to 56 of this Ruling.

8. 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

10. This Ruling applies to the class of entities who participate in the scheme from 1 July 2007 to 30 June 2012. 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).

11. Furthermore, the Ruling only applies to the extent that:

- It is not later withdrawn by the Gazette;
- It is not taken to be withdrawn by an inconsistent later public ruling; or
- The relevant tax laws are not amended.

12. This Ruling is withdrawn and ceases to have effect after 30 June 2012. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all entities within the specified class who enter into and carry out the specified arrangement during the term of this Ruling.

Changes in the law

13. Although this Ruling deals with the income tax laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such amendments may mean that this Ruling ceases to have effect or that its operation is materially affected.

14. On 12 May 2009, the Treasurer announced that from and including the income year 2010-2011 the Government will replace the Research and Development (R&D) Tax Concession with a simplified R&D Tax Credit. This change may affect the application of this Ruling.

15. As this change has not yet been enacted no Ruling can be made in relation to it. Eligible companies who are considering participating in the scheme are advised to confirm with their taxation adviser whether or not changes in the law have affected this Ruling since it was issued.

Scheme

16. 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:

- The application for class ruling and accompanying attachments dated 19 August 2009;
- Letter to the Tax Office from the applicant and accompanying attachments dated 23 October 2009;
- Letter to the Tax Office from the applicant and accompanying attachments dated 6 November 2009;
- Letter to the Tax Office from Trevor Smith and accompanying attachments dated 9 March 2010;
- E-mail to the Tax Office from Trevor Smith dated 12 March 2010;
- E-mail to the Tax Office from Ian Wilson and accompanying attachments dated 13 April 2010;
- Letter to the Tax Office from the applicant and accompanying attachments dated 5 July 2010;
- Letter to the Tax Office from the applicant dated 29 July 2010;
- Letter to the Tax Office from the applicant dated 30 July 2010; and
- *Clean Coal Technology Special Agreement Act 2007* (Qld) and Schedule.

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

17. 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 R&D and demonstration in the areas of low emissions technologies associated with the use of coal.

18. The Australian black coal industry accepted the need to arrange a new program consistent with the Coal21 National Action Plan. A new program, 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 will be provided by way of voluntary levies.

Clean Coal Technology Special Agreement Act 2007 (Qld) and Schedule

19. The object of this act is to accelerate the development, demonstration and widespread implementation and use of clean coal technology by encouraging collaborative investment, by the State of Queensland and the coal industry in R&D and demonstration.

20. ACA Low Emissions Technologies Limited agrees that the Queensland Contribution will be spent on Queensland Clean Coal Technology Projects or on National Clean Coal Technology Projects approved or determined by the Premier and will not be used for any other purpose. One of the projects identified that will be funded from the Queensland Contribution is the project that is the subject of this class ruling.

ACALET

21. ACALET has been established to manage the ACALET Program. ACALET is not a registered research agency under section 39F of the *Industry Research and Development Act 1986*.

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

- to provide 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;
- to allocate the funds raised among registered research agencies and other research agencies and demonstration projects agencies chosen by the company to undertake research and/or demonstration projects;

- to act as a catalyst to stimulate research and development and demonstration project interest within the coal and associated industries;
- to improve the management and application of coal research and demonstration projects in Australia;
- to ensure a more efficient use of Australia's black coal resources;
- to increase the economic, environmental safety and social benefits to the coal industry and wider community;
- to promote competitiveness, sustainable use and management of Australia's coal resources;
- to enter into contracts with and engage organisations to manage research projects and/or demonstration projects on behalf of groups of companies.

23. Each coal producer group operating in Australia has the opportunity to be a member of ACALET. The Board of ACALET comprises of up to 12 directors nominated by the members of ACALET as Non Executive Directors and the Executive Director appointed by ACALET.

24. 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.

25. As detailed in paragraph 18 of this Ruling, participation in this project is voluntary. Any payments made by a contributing company 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 relating to the ACALET Program between ACALET and the operator of coal producing assets or contributor (Contribution Deed)

26. 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 make contributions (contributions or 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'.

27. 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.

28. The contributors agree to pay the 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 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 contributor to the extent possible, under the terms of the various agreements entered into by ACALET in relation to the ACALET Program.

29. Contributions accrued by the contributor are calculated up to a maximum of $0.20 per tonne of coal produced by the contributor from the coal producing assets from 1 April 2007. The initial rate is $0.10 per tonne of coal produced commencing on 1 April 2007 until 30 June 2007 and is $0.20 per tonne of coal produced for the year commencing 1 July 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.

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

31. 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) the training of persons for the purpose of any such R&D;

(b) the publication of reports, periodicals, books and papers in connection with such R&D;

(c) the 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) any matters incidental or relating to a matter referred to in this definition; and

(e) any matters incidental or relating to the obligations of ACALET under this Deed including costs incurred in collection of contributions.

32. 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 or the application of an existing overseas technology or process to Australian circumstances.

33. 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 contributing companies have a range of tax year-end dates. These quarterly reports are derived from a 'contributor reporting spreadsheet' developed by ACALET, and set out the contributor's percentage of the eligible research and development expenditure (R&D expenditure) and other expenditure spent on the project or on related overheads for the quarter. It is intended that a relevant taxpayer's claim under section 73B, 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.

34. 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, and will continue to the later of such date the parties agree or the date upon which the accrual balance is nil, unless earlier terminated. The effective date will vary for companies, as some entered into the deed prior to 30 June 2007 and some after this date.

35. 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 contributing companies.

36. 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.

37. The expenditure is not a 'pre-RBT obligation' as defined in subsection 82KZL(1).

ACALET's funding and operations

38. Contributions paid to ACALET by contributing companies are used to fund the Callide Oxyfuel Project (the project), which has been identified as a suitable candidate for funding by ACALET through the ACALET Program. The project is expected to continue for a number of years.

39. ACALET enters into a Funding Agreement with those companies that are parties to the project. ACALET agrees to provide funding for the project. It is also agreed that all funding provided by ACALET and other parties must be used for the sole purpose of performing the project and must not be used for any other purpose.

40. The project is carried out on a collaborative basis with cash and in kind contributions also made by these other parties to the project. Some of the other parties to the project also provide background intellectual property for use in the project.

41. The other parties to the project also incorporate another company as the person to undertake the project.

42. In the Funding Agreement, other parties to the project agree to provide to ACALET on a quarterly basis for the life of the project a report setting out:

- an estimate of the proposed expenditure relating to the project for the next quarter, apportioned between R&D expenditure as defined in subsection 73B(1) and demonstration expenditure; and
- a statement reconciling expenditure including apportionment between R&D expenditure as defined in subsection 73B(1) and demonstration expenditure actually incurred during the immediately proceeding quarter and the previous estimate of the proposed expenditure relating to the project for the quarter.

43. As a result of other relevant agreements entered into regarding the project, the Project Director is responsible for the preparation of an annual project program and annual budgets for the project for approval and adoption by the Management Committee of the project. It is also agreed that ACALET will have access to certain other reports as a result of these other agreements which the Project Director must also ensure are prepared for approval:

- quarterly reports showing the progress of the project against the operating plan and quarterly accounts; and
- annual reports prepared for each financial year providing details including the annual accounts, the annual project program and the status of the project conducted pursuant to that program and the annual budget for the following year.

44. To date some quarterly reports have been provided illustrating the apportionment of the contributions made by all parties to the project (including those made by ACALET for contributing companies) between expenditure that is eligible R&D and expenditure that is ineligible for R&D.

45. The company incorporated to undertake the project must prepare work programs and budgets before commencing work on the project for approval by the parties to the project. The company must also prepare annual statements of projected cashflow and monthly reconciliation reports specifying details including the total project expenditure to date, the total cash paid to the company to date, the balance of the project account, variations to the work project or budget and expenditure against budget for each work program and budget.

46. It is expected that the budgets, projected cashflows and details of the project expenditure provided by the company as mentioned above, feed into reports required to be prepared by the Project Director and ultimately the quarterly reports that the parties to the project agree to provide to ACALET.

47. Intellectual property resulting from the project will not be legally owned by contributing companies. Contributing companies also will not own any assets acquired in the course of the project and are not the holder of any section 73BA of the ITAA 1936 depreciating assets under section 40-40 of the ITAA 1997. Further, by making contributions to the ACALET Program, the contributing companies are not acquiring or acquiring the right to use any existing technology for the purposes of research and development activities (R&D activities).

48. Other parties to the project must provide a final report to ACALET or such other persons as ACALET nominates describing all work done in connection with the project. It is agreed that ACALET may publish the final report. ACALET will make this report available to each of the contributors which can then be made available to contributing companies (where they are different entities).

49. Contributing companies receive the same rights in relation to the use of project intellectual property for internal purposes as other parties to the project. In addition, similarly to other parties, contributing companies may also be able to obtain a manufacturing licence.

50. Benefits received by contributing companies and other parties to the project including their interest in the results of the projects concerned, are commensurate with the contributions made.

51. Some contributions made by contributing companies to ACALET are also used by ACALET for management and administration activities in respect of the project.

52. Levies paid to ACALET by contributing companies constitutes ‘expenditure incurred’ for the purposes of the definition of R&D expenditure in subsection 73B(1) of the ITAA 1936 and for the purposes of section 8-1 of the ITAA 1997. Levies paid by each contributing company 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 contributing companies, but rather are intended to assist them in marketing of their products.

R&D activities

54. The applicant has provided details of the R&D activities of the project that will partly be funded by contributions of contributing companies. These activities are listed below:

Stage 1 – boiler refurbishment/retrofit for CO_2 capture

- Design and implement site preparation and works to ensure structural integrity of test equipment associated with the oxyfuel retrofit.
- Design and develop process for refurbishment and recommissioning existing boiler to standard to enable successful retrofit of oxyfuel combustion technology.
- Test plant on air fired operation to ensure the success for the refurbishment.
- Commissioning of retrofitted boiler to ensure fully operational prior testing of technology.
- Design air separation unit plan, installation, integration and commissioning for supply of oxygen to test oxy combustion.
- Design, develop and test new application of flue gas processing and liquefaction plant to eliminate more elaborate multi stage processing, installation, integration and commissioning.
- Design, development and construction to resolve uncertainty regarding integration of components for boiler retrofit to enable use of the oxyfiring technique.
- Test operation of unit 4 of the power station, including operation of oxyfuel boiler and separation of liquefied carbon dioxide for four year period, including trials different operational modes and potentially, different coal types.

Stage 2 – CO_2 geosequestration – technology in its infancy so many uncertainties

- Potential geosequestration site selection studies including preliminary site characterisation and analysis.
- Site characterisation and analysis to develop reservoir models for CO_2 injection.
- Design and fabrication of field works for CO_2 injection including injection and modellings wells.
- Develop reservoir remodelling to incorporate findings of CO_2 injection.
- Site construction and commissioning to enable CO_2 injection.
- Test program for CO_2 injection and monitoring.

Stage 3 – project analysis and verification

- Post project monitoring, verification of technology, project analysis to assess success of R&D and site rehabilitation.

Commonwealth funding

55. The Commonwealth has agreed to provide grant funding for the purposes of the project.

56. Any receipt of the Commonwealth funding in relation to the project by a contributing company or their group member under section 73L is outside the scope of this ruling. If any contributing company in these circumstances wants to know whether section 73C applies to them they should apply for a private ruling on this matter.

Ruling

Subsections 73B(14) and 73B(9)

57. For the years of income ending 30 June 2008 to 30 June 2012 inclusive (or equivalent substituted accounting periods), to the extent that contributions made in an income year are $1,000 or more and are incurred directly in respect of R&D activities as defined in subsection 73B(1), contributing companies can claim a deduction under subsection 73B(14). Subsection 73B(9) will not prevent this deduction from being allowable.

58. No deduction is allowable under subsection 73B(14) of the ITAA 1936 for a contributing company:

- for any proportion of the contributions applied to the performance of activities that do not come within the definition of R&D activities (as defined in subsection 73B(1) of the ITAA 1936); or
- for any proportion of the contributions that relate to activities for which an unfavourable certificate has been issued under sections 39L or 39S of the *Industry Research and Development Act 1986*; or
- if that company is not registered with Innovation Australia (the Board), as required by subsection 73B(10) of the ITAA 1936 for a particular income year; or
- if that company's aggregate research and development amount as defined in subsection 73B(1) of the ITAA 1936 is $20,000 or less.

59. The Commissioner acknowledges that any opinion formed about the R&D activities referred to in paragraph 54 of this Ruling can be overridden by the Board. Therefore, the Commissioner does not express an opinion about these activities and whether they are eligible R&D activities as defined in subsection 73B(1). The ruling is made on the presumption (unless told otherwise by the Board) that the activities are eligible R&D activities as defined under subsection 73B(1).

Section 82KZMD

60. Where expenditure deductible under subsection 73B(14) is for R&D activities to be carried on not within the expenditure year, section 82KZMD applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

Section 73C

61. Section 73C does not apply to any expenditure incurred by contributing companies that are not recipients of (or their section 73L group members are not recipients of) the Commonwealth grant. Any contributing company that is a recipient of the Commonwealth funding (or has a section 73L group member that is) in relation to the project is outside the scope of this Ruling. If a contributing company in these circumstances wants to know whether section 73C applies to them they should apply for a private ruling.

Section 8-1

62. For the years of income ending 30 June 2008 to 30 June 2012 inclusive (or equivalent substituted accounting periods), the portion of the levy paid by the contributing companies to the ACALET Program, which does not qualify for a deduction under section 73B of the ITAA 1936, will be deductible under section 8-1 of the ITAA 1997.

Section 82KZMD

63. Where expenditure deductible under section 8-1 of the ITAA 1997 is for activities to be carried on not within the expenditure 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
25 August 2010

Appendix 1 – Explanation

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.

Subsection 73B(14) – research and development expenditure (R&D expenditure)

64. Subsection 73B(14) allows a deduction if an eligible company incurs R&D expenditure (other than contracted expenditure) during a year of income if the company's aggregate research and development amount is greater than $20,000 (subject to any other relevant requirements in section 73B being satisfied).

65. In accordance with subsection 73B(14), the deduction an eligible company can claim is calculated by multiplying the expenditure incurred by 1.25 in each year of income.

66. A deduction will be available in a year of income under subsection 73B(14) if:

- an eligible company with an aggregate research and development amount greater than $20,000 incurs R&D expenditure (as defined in subsection 73B(1)) during a year of income; and
- the deduction is not prevented by other provisions of section 73B.

67. Given that there is no partnership between contributing companies, subsections 73B(3A) and 73B(3B) do not apply.

Eligible company

68. An eligible company means a body corporate incorporated under a law of the Commonwealth or a State or Territory (subsection 73B(1)).

69. The class of entities to which this Ruling applies comprises eligible companies within the meaning of subsection 73B(1). Therefore this requirement is satisfied for the class of entities to which this Ruling applies.

Aggregate research and development amount

70. To qualify for a deduction under subsection 73B(14), an eligible company must also have an aggregate research and development amount that exceeds $20,000. The term aggregate research and development amount is defined in subsection 73B(1).

71. As the class of entities that this Ruling applies to comprises eligible companies with an aggregate research and development amount exceeding $20,000, this requirement is satisfied. Note that any company that does not have an aggregate research and development amount exceeding $20,000 will not be entitled to claim a deduction under subsection 73B(14).

Incurs R&D expenditure

72. Contributing companies pay contributions to ACALET in accordance with the Contribution Deed. Contributing companies therefore incur expenditure that is paid to the program for the purposes of subsection 73B(14).

73. In accordance with subsection 73B(1), R&D expenditure is defined as:

> in relation to an eligible company in relation to a year of income, means expenditure (other than core technology expenditure, interest expenditure, feedstock expenditure, excluded plant expenditure or expenditure incurred in the acquisition or construction of a building or of an extension, alteration or improvement to a building) incurred by the company during the year of income, being:
>
> (a) contracted expenditure of the company;
>
> (b) salary expenditure of the company, being expenditure incurred on or after 1 July 1985; or
>
> (c) other expenditure incurred on or after 1 July 1985 directly in respect of research and development activities carried on by or on behalf of the company on or after 1 July 1985;
>
> and includes any eligible feedstock expenditure that the company has in respect of the year of income in respect of related research and development activities.

Excluded expenditure

74. Certain expenditure is excluded from the definition of R&D expenditure. It is not considered that contributions to the ACALET Program result in contributing companies having any of the excluded expenditure types as listed in paragraph 73 of this Ruling, for the reasons below:

- core technology expenditure (by making contributions to the ACALET Program, the contributing companies are not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities);
- interest expenditure (contributions are not interest or an amount in the nature of interest incurred in the financing of R&D activities);

- feedstock expenditure (contributions are not incurred by the contributing companies in acquiring or producing materials or goods to be the subject of processing or transformation by the company in R&D activities);
- excluded plant expenditure (contributing companies are not the holder of any section 73BA depreciating assets under section 40-40 of the ITAA 1997 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 a section 73BA of the ITAA 1936 depreciating asset); and
- expenditure incurred in the acquisition or construction of a building or of an extension, alteration or improvement to a building (contributing companies do not own any building as a result of their contributions to the ACALET Program and therefore contributions cannot be seen to be for acquiring, constructing, altering or improving a building).

R&D expenditure

75. The expenditure in question is not paid to the Coal Research Trust Account nor to a registered research agency under section 39F of the *Industry Research and Development Act 1986*. Therefore, the expenditure is not contracted expenditure as defined in subsection 73B(1) of the ITAA 1936. Further, the expenditure is not for payments made to/for an officer or employee of the contributing companies (for example, salary, superannuation, pay-roll tax or worker's compensation). Therefore, the expenditure is not salary expenditure as defined in subsection 73B(1) of the ITAA 1936.

76. The question then is whether the expenditure falls within paragraph (c) of the definition of R&D expenditure. The expenditure is incurred on or after 1 July 1985, so the issues to consider are:

- whether the expenditure is incurred directly in respect of R&D activities; and
- whether the activities are carried on by or on behalf of the contributing companies.

77. Whether R&D activities are to be carried out 'on behalf of' contributing companies as required by the definition of R&D expenditure in subsection 73B(1) and not on behalf of any other persons besides the contributing companies, for the purposes of subsection 73B(9), is considered in paragraphs 85 to 107 of this Ruling. Note that the activities in question are not carried out by any of the contributing companies.

Whether the expenditure is incurred directly in respect of R&D activities

78. The meaning of the phrase 'directly in respect of' has not yet been judicially considered in the context of subsection 73B(1). However, the meaning given to 'expenditure directly in producing a film', in *Federal Commissioner of Taxation v. Faywin Investments Pty Ltd* (1990) 22 FCR 461; 90 ATC 4361; (1990) 21 ATR 256 (*Faywin*), of requiring a sufficiently close connection between the expenditure and the film production is thought to provide an appropriate guide to what will be required for expenditure to be 'directly in respect of' R&D activities. As in *Faywin*, just because the expenditure may have been incurred to an intermediary, will not of itself preclude the expenditure from being directly in respect of the R&D activities in question.

79. Factors to consider are the terms and conditions under which the expenditure might have been incurred, and how they might link the expenditure to the performance of the relevant R&D activities, the time elapsed between when the expenditure was incurred and when the R&D activities in question are carried out, whether the expenditure can be seen in a practical sense to give rise to those activities, and whether the expenditure can reasonably be expected to produce results from those activities on behalf of the company incurring that expenditure.

80. The terms of the Contribution Deed show that contributions will be applied exclusively in respect of R&D, demonstration projects and management and administration expenses relating to the above. The Funding Deed specifies contributions can only be used for the purposes of the project. Some of the contributions will therefore be directed towards R&D activities listed in paragraph 54 of this Ruling. Similarly to other parties to the project, contributing companies benefit from the results of the R&D activities, including receiving final reports and also have the same rights in relation to the use of project intellectual property for internal purposes as other parties to the project. This shows there is a practical link between the expenditure and the activities and the results to be produced from the activities.

81. 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 of the project, such that this expenditure qualifies as being 'directly in respect of' 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.

82. This conclusion is not prevented by the fact that payments are made to an intermediary.

83. Note that the definition of R&D expenditure in subsection 73B(1) also requires that the relevant R&D activities are undertaken 'on behalf of' the company (in this case the 'company' refers to a contributing company). Expenditure will not be R&D expenditure unless this additional requirement is satisfied, which it is in this case.

Is the deduction otherwise precluded under section 73B?

84. As mentioned in paragraph 66 of this Ruling, a deduction is only available under subsection 73B(14) if all other relevant requirements of section 73B are satisfied. Two subsections that must be considered in this respect are:

- subsection 73B(9); and
- subsection 73B(10).

Subsection 73B(9) – 'on behalf of any other person'

85. Subsection 73B(9) provides that a deduction is not allowable under section 73B (except subsection 73B(14C)) in respect of expenditure incurred by an eligible company for the purpose of carrying on R&D activities 'on behalf of any other person'. Expenditure of that kind is disregarded for the purposes of the application of section 73B (except subsections 73B(14C) and 73B(14D)) to the company. Note that subsections 73B(14C) and 73B(14D) refer to deductions that can be claimed for expenditure on foreign owned R&D. These provisions are not relevant to this Ruling, as the expenditure in question is not expenditure on foreign owned R&D as defined in subsection 73B(14D).

86. There is a link between subsection 73B(9) and the requirement set out in the definition of R&D expenditure in subsection 73B(1). Expenditure incurred by an eligible company will only qualify as R&D expenditure as defined in subsection 73B(1) if R&D activities are carried out 'by or on behalf of' the company.

87. Therefore, contributing companies paying levies to ACALET will only be able to claim a deduction under section 73B, if the expenditure is incurred directly in respect of R&D activities carried out on behalf of that contributing company, and not incurred for the purpose of carrying out those activities on behalf of any other person (subject to the other requirements in section 73B being satisfied).

Purpose

88. The purpose under consideration is that of the relevant expenditure, determined at the time of incurring the expenditure. Contributing companies pay levies in accordance with the Contribution Deed.

89. Contributing companies are aware of the contents of this Deed, including the activities to which it refers, at the time the expenditure is incurred. Therefore, the purpose of the expenditure of this nature is to fund those activities (including R&D).

'on behalf of'

90. A levy imposed on industry members as a means of raising funds to support R&D activities may qualify for the concession to the extent that the levy payments are expended on qualifying R&D activities carried out 'on behalf of' those industry members. For R&D activities to be carried out by or on behalf of a company that is an industry member, there must be a close and direct link between the company and the work undertaken.

91. However, in accordance with subsection 73B(9), an eligible company generally cannot claim a deduction at the concessional rate in respect of expenditure incurred for the purpose of carrying on R&D activities on behalf of any other person. It is not necessary that the company be acting as an agent of the other person; the question is whether, in all the circumstances, the R&D is to be carried out in substance on behalf of the other person. This will be a question of fact in each case.

92. There has been no judicial interpretation of the phrase 'on behalf of' as used in the section 73B. However, the phrase has been considered by the courts in relation to its use in other statutory contexts as outlined in Class Ruling CR 2009/45.[1] We consider that these cases are also relevant for the purposes of this Ruling and the relevant principles are summarised below.

- A determination of whether a payment or act is done 'on behalf of' a person must be made objectively on the evidence provided.[2]
- The phrase 'on behalf' does not have strict legal meaning and can be used in a wider sense than the legal relation of principal and agent.[3]
- An examination needs to be made of whether a payment is made 'substantially in the interest of' the payer or another and the 'extent of the comparative benefit' it confers.[4]

93. The factors discussed in paragraph 94 of this Ruling are also considered relevant.

94. The requirements in provisions such as subsection 73B(1) and subsection 73B(9) (collectively referred to as the 'on own behalf requirement') effectively prevent double deductions being claimed in respect of the same R&D activities by restricting entitlement to the concessional deductions to the eligible company that:

- has control over the R&D project;[5]

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[1] Class Ruling CR 2009/45 Income tax: research and development: membership funding for the Australian Coal Association Research Program
[2] *Cuthbertson and Richards Sawmills Pty Ltd v. Thomas* (1999) 93 FCR 141.
[3] *R v. Portus; Ex parte Federated Clerks Union of Australia* (1949) 79 CLR 428.
[4] *Federal Commissioner of Taxation v. Robinson* 92 ATC 4424; (1992) 23 ATR 364.
[5] This can be control by a group as a whole.

- effectively owns the project results; and
- bears the financial risk associated with an R&D project.

95. Arrangements which in substance abdicate either ownership or control could compel the conclusion that R&D activities were not being carried out on behalf of the company. In order to determine if R&D activities are undertaken on behalf of the contributing companies paying levies to ACALET it is necessary to consider how the factors referred to at paragraph 94 of this Ruling apply to these companies.

Control

96. It is considered that the contributing companies, 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 contributing companies 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 contributing companies have sufficient control over the R&D activities.

Effective ownership

97. A company effectively owning results of the relevant R&D activities is another pointer to those activities being carried out on behalf of that company. However, it is recognised that this does not necessarily require that the company must be the proprietor of a piece of intellectual property, as formal regimes of intellectual property may not be available to protect the results. Further, it is possible that the formal owner of the intellectual property 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. Co-owners who can, as a practical matter, make use of their results in their individual activities often do not make any specific agreements about their rights as between themselves. For instance, members of industry associations may be effectively co-owners of the R&D results obtained on their behalf. Free individual use of those results is practical for them. Co-ownership of this kind is consistent with the R&D having been carried out on behalf of the individual co-owners, each of whom has a proper and effective separate interest in the results. Where each such co-owner makes a contribution, even if the contributions vary somewhat, those contributions would not usually be regarded as having been made for the purpose of carrying out R&D activities on behalf of the other co-owners.

100. Where co-owners must effectively share results or their use, the question will be whether their individual share in those results is commensurate with their contribution. This is determined by a comparison of the contributions of the co-owners to the R&D activities with their interest in or share of the results.

101. In addition, it is important to consider whether a company's interest in the overall results is appropriate to its contribution to overall research in circumstances where the research builds on existing research belonging to another person. The same principles apply when considering circumstances where the substance of a proposed arrangement shows the researcher is the holder of its own research results and their interest in the results of the R&D activities reflects their contribution.

102. ACALET uses levies paid by contributing companies to fund the project. Any intellectual property generated as a result of the project will not be legally owned by contributing companies. However, we are more concerned with effective ownership of the results of the R&D projects and whether the benefits obtained by contributing companies are such that they have an interest in the results of the projects that is commensurate with their contributions.

103. The Contribution Deed between ACALET and the operator of coal producing assets or contributor (in some cases on behalf of the mine owner) 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'.

104. In order to determine whether contributing companies' 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 contributing companies.

105. An examination of the benefits that contributing companies 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.

Financial risk

106. In accordance with the Contribution Deed, contributing companies 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 contributing companies.

107. As contributing companies pay non-refundable levies, we consider that the contributing companies bear the financial risk associated with the R&D activities undertaken.

Subsection 73B(10) – registration

108. In accordance with subsection 73B(10) of the ITAA 1936, a deduction is not allowable under subsection 73B(14) of the ITAA 1936 unless the company is registered for the activities to which the expenditure relates under section 39J of the *Industry Research and Development Act 1986*.

109. The class of entities to which this Ruling applies comprises companies registered in relation to specific R&D activities in accordance with the requirements of subsection 73B(10). Therefore, this requirement is satisfied for the class of entities to which this ruling applies.

Summary

110. Contributions incurred by contributing companies to ACALET that are directly in respect of R&D activities carried out 'on behalf' of the contributing companies will be deductible under subsection 73B(14). Subsection 73B(9) will not preclude the deduction under subsection 73B(14) from being allowable. However, the prepayment rules discussed in paragraphs 122 to 134 of this Ruling, may impact on the amount and timing of any deduction available.

Clawback

111. Section 73C applies where:

- an eligible company has incurred expenditure (*relevant expenditure*) on R&D activities that formed or form part of a particular project carried on by or on behalf of the company; and
- the company (or another person it is grouped with under section 73L at the time of receipt of entitlement) has received, or become entitled to receive, a recoupment of, or a grant in respect of, the whole or any part of the *relevant expenditure* by or from the Commonwealth, a State or a Territory, an STB (within the meaning of Division 1AB) or an authority constituted by or under a law of the Commonwealth, of a State or of a Territory.

112. Any R&D expenditure that is subject to clawback is not deductible at a rate of 125%. Instead the amount of the expenditure is only deductible at a rate of 100%.

113. The Commonwealth has agreed to provide grant funding for the project. However, section 73C does not apply to any expenditure incurred by contributing companies that are not recipients of the grant and are not grouped under section 73L with any recipients of the grant at the time of the receipt or entitlement of the grant.

114. Any receipt of the Commonwealth funding by a contributing company or their section 73L group member in relation to the project is outside the scope of this ruling. If a contributing company in this position wants to know whether section 73C 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 that do not qualify for a deduction under section 73B

115. To the extent that a payment made by a contributing company does not qualify for a deduction under section 73B of the ITAA 1936, it may nevertheless be deductible under section 8-1 of the ITAA 1997. To be entitled to a deduction under section 8-1 of the ITAA 1997 a contributing company will need to satisfy subsection 8-1(1) of the ITAA 1997, and also not be precluded by any part of subsection 8-1(2) of the ITAA 1997.

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

- capable of being characterised as a 'working or operating expense' of the business of that contributing company; and
- necessarily incurred in carrying on the business of that contributing company.

Taxation Ruling TR 95/1[6]

117. 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*).

[6] Taxation Ruling TR 95/1 Income tax: deductibility of advertising that opposes the passing of legislation other Rulings on this topic.

118. The decision in *Rothmans* provides some assistance in determining a contributing company'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]

119. The principle established in *Rothmans* can be extended to include any portion of the levy payment (that does not qualify under section 73B), which can be properly characterised as being incidental to the contributing company's business.

120. Where a contributing company makes a payment to ACALET, which enables it to promote its involvement with the 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 contributing companies, but rather are intended to assist them in marketing their product.

121. Accordingly, in these circumstances, the payment will be deductible under subsection 8-1(1) of the ITAA 1997, and will not be precluded by any part of subsection 8-1(2) of the ITAA 1997.

Prepayments

122. The timing of any deductions that are available under subsection 73B(14) of the ITAA 1936 and section 8-1 of the ITAA 1997 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, the taxpayer could deduct expenditure under section 73B, 73BA, 73BH, 73QA, 73QB of the ITAA 1936 or the former section 73Y of the ITAA 1936 or section 8-1 of the ITAA 1997.
- The requirements in subsections 82KZMA(2) to (5) are met.

123. As discussed above, the requirements of subsection 73B(14) of the ITAA 1936 will be met for expenditure incurred directly in respect of R&D activities, and section 8-1 of the ITAA 1997 will be met for any remaining expenditure incurred by contributing companies to ACALET under the Contribution Deed. Therefore, it also needs to be considered whether the requirements of subsections 82KZMA(2) to (5) of the ITAA 1936 are also satisfied for the expenditure in question.

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

124. We consider that 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 contributing companies are carrying on a business or not;
- similarly, subsection 82KZMA(3) 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 120 of this Ruling, the expenditure is not capital in nature, and therefore is not excluded expenditure[7] as required by subsection 82KZMA(4). Further, none of the other excluded expenditure categories apply to the contributions made by the contributing companies; and

[7] Excluded expenditure, as defined in subsection 82KZL(1) to mean:
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.

- in accordance with subsection 82KZMA(5), the expenditure is not a pre-RBT obligation.[8]

125. In accordance with 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 contributing companies 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.

126. 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 the project manager requires funds in advance in order to see that the activities in question are begun.

127. 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 project to carry out budgeted activities on behalf of the contributing companies is the notion that each contribution is intended to fund only so much of these activities at any one time.

128. 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 the project manager'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

129. 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 subsection 73B(14) of the ITAA 1936 or section 8-1 of the ITAA 1997 determined using this formula:

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

[8] 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.

130. 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.

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

132. Identification of when the various activities are to commence and cease is best done by reference to the underlying planning and budgetary documentation that guides the project manager's actions. Determination of these commencement and cessation times will necessarily, in the circumstances, be one of reasonable estimation, rather than something that occurs with absolute precision.

133. Analysis of the project 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 project activities, 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.

134. 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.

Appendix 2 – Detailed contents list

135. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/1; TR 2006/10;
CR 2009/45

Subject references:

- on own behalf
- research and development expenditure

Legislative references:

- ITAA 1936
- ITAA 1936 Div 1AB
- ITAA 1936 73B
- ITAA 1936 73B(1)
- ITAA 1936 73B(3A)
- ITAA 1936 73B(3B)
- ITAA 1936 73B(9)
- ITAA 1936 73B(10)
- ITAA 1936 73B(14)
- ITAA 1936 73B(14C)
- ITAA 1936 73B(14D)
- ITAA 1936 73BA
- ITAA 1936 73BH
- ITAA 1936 73C
- ITAA 1936 73L
- ITAA 1936 73QA
- ITAA 1936 73QB
- ITAA 1936 73Y
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(2)
- ITAA 1936 82KZMA(3)
- ITAA 1936 82KZMA(3)(b)
- ITAA 1936 82KZMA(3)(c)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMA(5)
- ITAA 1936 82KZMD
- ITAA 1936 82KZMD(2)
- ITAA 1997
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(2)
- ITAA 1997 40-40
- ITAA 1997 328-110
- Industry Research and Development Act 1986 39F
- Industry Research and Development Act 1986 39J
- Industry Research and Development Act 1986 39L
- Industry Research and Development Act 1986 39S
- Clean Coal Technology Special Agreement Act 2007 (Qld)
- TAA 1953
- Copyright Act 1968

Case references:

- Cuthbertson and Richards Sawmills Pty Ltd v. Thomas (1999) 93 FCR 141
- Federal Commissioner of Taxation v. Robinson 92 ATC 4424; (1992) 23 ATR 364
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- Federal Commissioner of Taxation v. Faywin Investments Pty Ltd (1990) 22 FCR 461; 90 ATC 4361; (1990) 21 ATR 256
- Magna Alloys and Research Pty Ltd v. Federal Commissioner of Taxation (1980) 33 ALR 213; 80 ATC 4542; (1980) 11 ATR 276
- R v. Portus; Ex parte Federated Clerks Union of Australia (1949) 79 CLR 428

ATO references

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