CR 2012/82 - Income tax: research and development: membership funding for the Australian Coal Association Research Program

Class Ruling

Income tax: research and development: membership funding for the Australian Coal Association Research 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 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 82KZL of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KZMA of the ITAA 1936; and
- 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 persons to which this Ruling applies comprises 'R&D entities', as defined by Section 355-35 who are liable for levy contributions under the Australian Coal Association Research Program (ACARP) to Australian Coal Research Ltd (ACR), 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; 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 ACR under the ACARP Program. In the Deed of Agreement 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 Deed of Agreement.

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 ACARP 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.

7. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out accords with the scheme described in paragraphs 19 to 46 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.

Date of effect

10. This Ruling applies to the class of persons who participate in the scheme from 1 July 2011 to 30 June 2015. 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 *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 2015. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons 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.

Previous Rulings

14. Class Ruling CR 2009/45 was issued on 26 August 2009 and applied to income years ending 30 June 2011 to 30 June 2015. The Class Ruling concerned membership contributions made to ACARP in relation to the income tax laws enacted at the date of issue.

15. Following the issuing of the Class Ruling there was a significant legislative change in the *Tax Laws Amendment (Research and Development) Act 2011* (the Amendment Act) which received Royal Assent on 8 September 2011.

16. The Amendment Act inserted a new Division 355 into the *Income Tax Assessment* Act *1997* (ITAA 1997) and repealed sections 73B to 73Z of the *Income Tax Assessment Act 1936* (ITAA 1936).

17. Due to the legislative change, Class Ruling CR 2009/45 ceased to have effect from and including the income year ending 30 June 2012.

18. Class Ruling CR 2005/9 was issued on 9 March 2005, regarding membership funding for the ACARP. Class Ruling CR 2005/9 applied to the income years ended 30 June 2006 to 30 June 2010.

Scheme

19. 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 30 November 2011; and
- letter to the Tax Office from the applicant and accompanying attachments dated 22 December 2011.

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

Memorandum of Understanding

20. The ACARP was formed in accordance with a Memorandum of Understanding (MOU) between the Australian Coal Association (ACA) and the Commonwealth Government.

21. The MOU between the chairman of ACA and the then Minister for Primary Industries and Energy was first signed on 22 January 1992. The arrangement set out in the MOU was subsequently extended to 30 June 2005 and later to 30 June 2010. The Minister for Resources and Energy has agreed to a further extension of the arrangement in the MOU from the income years ended 30 June 2011 to 30 June 2015 inclusive.[1]

[1] Memorandum of Understanding between Minister for Resources and Energy and Australian Coal Association, dated 29 October 2009.

22. The purpose of the MOU is to provide for the establishment of an industry research arrangement to replace the operations of the Coal Research Trust Account (CRTA). The arrangement is designed to provide for collective and integrated research on coal for the purpose of:

- providing strategic leadership to industry R&D and to act as a catalyst to stimulate R&D interest within the coal and associated industries;
- improving the management and application of coal research in Australia; ensuring the more effective use of Australia's black coal resources;
- increasing the economic, environmental, safety and social benefits to the industry and wider community; and promoting the competitiveness; and
- sustainable use and management of Australia's coal resources.

23. The MOU explains that in the pursuit of these objectives the ACA undertakes to allocate research funds so raised, including interest earned, exclusively for the administration and execution of coal research and development activities.

Australian Coal Research Limited

24. ACA has established a legal entity, Australian Coal Research Limited (ACR) to carry out all ACARP Management (including financial and statutory responsibilities) on its behalf.

25. ACR's Constitution[2] describes its objects, many of which mirror those in the MOU.

26. The Board of ACR comprises senior industry personnel nominated by Contributors. In addition, ACR also has an executive director. All ACR Board members are also members of the ACA.

27. ACR is an income tax exempt entity.

28. ACR is currently registered as a registered service provider under section 29A of the *Industry Research and Development Act 1986* in relation to the categories of research and development activities that are carried out and will have its registration extended for the years relevant to this ruling.

29. ACR is not an 'associate' of any Contributors as defined in section 318 of the ITAA 1936.

[2] Constitution of Australian Coal Research Limited, dated September 2009.

Deed of Agreement between ACR and each operator of coal producing assets (Deed of Agreement)

30. Each affected coal producer (referred to as an 'operator of coal producing assets') enters into a Deed of Agreement with ACR 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 Deed of Agreement on behalf of each of the mine owners (contributing companies).

31. The operator agrees to pay a levy in consideration for:

- contributions to be applied exclusively in respect of research and development as defined in the agreement; and
- the results of the research and development will be made available to the operator.

32. Contributions are calculated at the rate of $0.05 per tonne of coal produced by the operator during the term of the agreement, on a monthly basis. All Contributions paid to ACR become property of ACR.

33. The Deed of Agreement[3] defines 'research and development' to mean scientific, technical or economic research in connection with the exploration, mining and beneficiation of coal or products derived from coal, including the demonstration and development thereof, and includes:

(a) the training of persons for the purpose of any such research and development;

(b) the publication of reports, periodicals, books and papers in connection with such research and development;

(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 ACR under this Deed of Agreement including costs incurred in collection of Contributions.

[3] Deed of Agreement, Australian Coal Association Research Program, between Australian Coal Research Limited and Operator.

34. In the Deed of Agreement ACR promises that contributions will be applied exclusively in respect of 'research and development'. It is noted that the definition of 'research and development' in the Deed of Agreement between ACR and the operator of coal producing assets is different to the definition of 'R&D activities' in section 355-20. However, the applicant advises that levies are directed only to those activities meeting the requirements of the definition of 'research and development' under the Deed. Activities outside of this definition are supported by non-levy funds.[4]

35. The Deed of Agreement 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. According to the Deed of Agreement, Contributors also have the right to access final research reports upon request.

36. All black coal producers in Australia are expected to enter into the Deed of Agreement and thus become liable to make contributions to ACR for the period 1 July 2010 to 30 June 2015.

ACARP's funding and operations

37. Levies paid to ACR by Contributors that are directed towards research and development activities (R&D activities), as defined in the Deed of Agreement, constitute expenditure incurred for the purposes of section 355-205.

38. All levy contributions are accepted as being used for R&D activities, as defined in the agreement. Levies fund projects carried out under Fundamental, Applied and Commissioned Study Research and Development Agreements to which ACR is a party. Other activities are funded by interest earned on funds held for future commitments and royalties.

39. It is rare that any projects are completely funded by ACARP. These projects are carried out on a collaborative basis with cash and in kind contributions made by other parties (including researchers).

40. Benefits received by Contributors and parties to these agreements from R&D projects including their interest in the results of the projects concerned, are commensurate with the contributions made.

41. Previous research has shown that ACARP delivers significant net benefits to the coal industry. WhileX ACR has obtained some commercialisation proceeds, this has been negligible, and is not expected to become a major benefit.

[4] Where the contributions are applied towards research and development activities as defined under the Deed and do not meet the definition of 'R&D activities' in section 355-20, apportionment of the expenditure will be required. This Ruling is made on the basis that levies are used to fund R&D activities as defined in section 355-20.

42. ACARP provides outcomes with general solutions to all aspects of concern to the Australian black coal industry as specified in the MOU, being the agreed purpose of the research program. All Contributors are capable by virtue of the relationship between those anticipated results and the nature of their business, of utilising the results of the R&D activities associated with each project directly in connection with a business that they carry on.

Research and Development Agreements – Fundamental, Applied and Commissioned Study

43. ACR enters into the following types of Research and Development Agreements with researchers:

- Fundamental;
- Applied; and
- Commissioned Study.

44. Between 30 June 2005 and the end of June 2010, ACARP commenced 270 projects under the above mentioned agreement types. Of these projects, 230 were undertaken under Fundamental Research and Development Agreements, 23 under Applied Research and Development Agreements, 8 under Commissioned Study Research and Development Agreements and 9 were not agreed to under formal agreements, but rather an exchange of letters or some other approach. There is no evidence to suggest that these proportions will materially change in the future.

45. Common to all three formal agreements are the following conditions:

- it is agreed by ACR and the researcher that a critical objective of the project is to make the results and outcomes of the research readily available to ACR on behalf of the Australian coal industry; and
- the researcher must submit a final report to ACR (describing all work done in connection with the project).[5] The researcher agrees that ACR may publish the final report.

46. Most of these agreements are entered into for the purpose of generating knowledge benefits for Contributors, and this is the dominant benefit arising out of these agreements.

[5] General Commissioned Study Agreement, clause 5.4; General Fundamental Agreement, clause 5.4; General Applied Agreement, clause 5.4.

Ruling

Subdivision 355-C – Entitlement to a tax offset

47. For the years of income ending 30 June 2012 to 30 June 2015 inclusive (or equivalent substituted accounting periods), to the extent that a Contributor pays levies in an income year that:

- are for R&D activities as defined in section 355-20; and
- represent expenditure as defined by reference to 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.[6]

48. 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; or
- 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.

49. The Commissioner acknowledges that any opinion formed about the R&D activities referred to in this Ruling can be overridden by 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 and section 355-205

50. 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.

[6] Subdivision 355-F may prevent a notional deduction arising under section 355-205. As discussed in paragraphs 71 to 75, this Ruling does not consider the application of Subdivision 355-F to the scheme described in paragraphs 19 to 46.

Section 8-1

51. For the years of income ending 30 June 2012 to 30 June 2015 inclusive (or equivalent substituted accounting periods), the portion of the levy paid by a Contributor to the ACARP Program, which does not qualify for a notional deduction under Subdivision 355-D, will be deductible under section 8-1.

Section 82KZMD and section 8-1

52. 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
26 September 2012

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.

Meaning of R&D activities and other terms

53. 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 by ACR are taken to be R&D activities undertaken by the Contributors.

54. In the event that the Board determines that:

- a Contributor is not eligible for registration in relation to the activities that ACR conducts in relation to the ACARP Project; or
- the activities of the ACARP 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).

then the Contributor cannot rely on this Ruling.

R&D Entities

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

(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***.

56. The class of persons to which this Ruling applies (contributing companies) 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 R&D tax offset

57. 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.

58. Ordinarily, notional deductions will need to be of at least $20,000 in the year of income to be eligible for a R&D tax offset. Where the expenditure is incurred to a registered research service provider, it is not subject to the $20,000 threshold requirement (subsection 355-100(2) Item 2).

59. 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); or
- 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

60. Contributors pay contributions to ACR in accordance with the Deed of Agreement. Therefore, they incur expenditure when these payments are made. To the extent that the payments are 'incurred *on* one or more R&D activities', they will be expenditure within the meaning of section 355-205 and as such they will constitute a notional deduction to the R&D entity (Contributor) subject to the application of the prepayment rules (discussed below).

61. 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 for the year of income;
- has notional deductidons of at least $20,000 for that year of income (unless incurred to a registered research service provider); 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'*

62. 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.

63. 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)).

64. 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.

65. 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).

66. 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.

67. The information provided by the applicant demonstrates that the amounts identified as relating to R&D activities for the purposes of section 355-20, are appropriately recognised in the reports prepared by ACARP for its Contributors. This enables a Contributor to correctly ascertain the amount of their levy contribution which has been expended on particular R&D activities identified as part of the relevant projects. Therefore, the first requirement is satisfied.

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

68. 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.

69. 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

70. As the class of entities that this Ruling applies to comprise R&D entities that have incurred expenditure to a registered research service provider,[7] the $20,000 notional deduction threshold requirement does not need to be met.

Preclusion by other provisions

71. 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

72. 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 ACARP Program result in Contributors having any of these 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 and their expenditure is not excluded expenditure within this type;
- Contributors are not the holder of any Division 40 depreciating assets under section 40-40 as a result of their contributions to the ACARP, 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
- Contributors are not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities.

[7] Registered under 29A Industry *Research and Development Act 1986*.

Integrity rules

73. 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 (the EM) explains that Subdivision 355-F was intended to preserve (in a corresponding way), the integrity provisions in the existing R&D provisions.

74. 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).

75. 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

76. Contributions are not being paid to any entity that is part of the Commonwealth government's CRC program.

R&D partnerships

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

Conditions for R&D activities

78. 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
- that the R&D activities are not being carried, to a significant extent, for one or more other entities not covered by any paragraph of subsection 355-210(1).

79. 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 80 to 98 of this Ruling. Note that the activities in question are not carried out by any of the Contributors.

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

80. Entitlement to a notional deduction under section 355-205 for the payment of levies to ACARP 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 that 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).[8]

81. 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.
>
> 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.

[8] 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).

82. 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

83. 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.

84. 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.

85. Under the scheme that is the subject of this Ruling, ACR uses levies paid by its Contributors to fund R&D activities. Any intellectual property generated as a result of the relevant R&D activities will not be legally owned by the Contributors.

86. In addition to having an interest in the relevant R&D activities, Contributors must have effective ownership of the overall results of the relevant project, such that they have an interest in the overall results of the relevant project which is commensurate with their contributions.

87. The Deed of Agreement between ACR and the operator of coal producing assets (on behalf of the mine owner) warrants ‘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 agreement’.

88. In order to determine whether 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.

89. 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 arrangement 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.

90. The fact that ACR may receive minimal commercialisation proceeds does not alter this conclusion.

Control

91. 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 ACR to provide. The Contribution Deed has set the parameters for the R&D to be undertaken and the underlying philosophies which ACR is bound to follow. The Contributors have effective legal control, as they have the ability to compel ACR to perform in accordance with the Deed of Agreement. 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

92. 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 Deed of Agreement, Contributors pay contributions which are calculated at a rate of up to $0.05 per tonne of coal produced (sold) over the term of the agreement. Payments are required on a monthly basis. The Deed of Agreement makes it clear that these contributions become the property of ACR. These contributions cannot be refunded to Contributors.

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

Summary

94. The terms of the Deed of Agreement show that contributions to ACR will be applied exclusively for R&D, demonstration projects and also for management and administration expenses relating to the above.

95. Contributors benefit from the results of the R&D activities, including receiving access to final reports. This shows there is a practical link between the expenditure and the activities and the results to be produced from the activities.

96. The above 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 ACARP 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.

97. An examination of the benefits that the 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.

98. Contributions incurred by Contributors to ACR that are directly in respect of R&D activities carried out 'for' the Contributors represents expenditure giving rise to a notional deduction for the purposes of Subdivision 355-D. Subsection 355-210 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.

Section 8-1 general deduction

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

99. 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).

100. 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.

Prepayment

101. 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 ACARP Contributor's assessable income; and
- the requirements in subsections 82KZMA(2) to (5) of the ITAA 1936 are met.

102. As discussed above, the requirements of section 355-205 (R&D expenditure) will be met for expenditure incurred directly in respect of R&D activities, and those for section 8-1 will be met for any remaining expenditure incurred by Contributors to ACR under the Deed of Agreement. 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

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

- subsection 82KZMA(2) will be satisfied irrespective of whether the Contributors 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);
- as explained in paragraph **72** of this Ruling, the expenditure is not capital in nature, and therefore is not excluded expenditure[9] as required by subsection 82KZMA(4). Further, none of the other excluded expenditure categories apply to the contributions made by the ACARP contributors; and
- in accordance with subsection 82KZMA(5), the expenditure is not a pre-RBT obligation.[10]

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[9] 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.

[10] 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

104. 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 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.

105. 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 ACR requires funds in advance in order to see that the activities which are the subject of the ACARP Project are begun.

106. 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 ACARP 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.

107. 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 ACR'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

108. 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:

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

(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.

109. 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.

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

111. There is an inherent or expected degree of imprecision when applying the calculation required under section 82KZMD. As discussed in paragraph 107, with reference to ACARP'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.

112. Analysis of the ACARP 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 the activities of the ACARP 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.

113. 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

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2005/9;
CR 2009/45

Subject references:

- on own behalf
- research and development tax offsets

Legislative references:

- Copyright Act 1968
- Industry Research and Development Act 1986 39F
- Industry Research and Development Act 1986 39J
- Industry Research and Development Act 1986 39K
- Industry Research and Development Act 1986 27A
- Industry Research and Development Act 1986 27J
- Industry Research and Development Act 1986 Div 4
- ITAA 1936 73B(1)
- ITAA 1936 73B(9)
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- 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 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(2)
- ITAA 1997 Div 40
- ITAA 1997 40-40
- ITAA 1997 328-110
- ITAA 1997 Div 355
- ITAA 1997 355-20
- ITAA 1997 355-25
- ITAA 1997 355-30
- ITAA 1997 355-35
- ITAA 1997 Subdiv 355-C
- ITAA 1997 355-100
- ITAA 1997 355-100(1)(a)
- ITAA 1997 355-100(1)(b)
- ITAA 1997 355-100(1)(c)
- ITAA 1997 355-100(1)(d)
- ITAA 1997 355-100(1)(e)
- ITAA 1997 355-100(1)(f)
- ITAA 1997 355-100(1)(g)
- ITAA 1997 Subdiv 355-D
- ITAA 1997 355-205
- ITAA 1997 355-205(1)
- ITAA 1997 355-205(1)(a)(i)
- ITAA 1997 355-210
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- ITAA 1997 355-210(1)(a)
- ITAA 1997 355-210(2)
- ITAA 1997 355-225
- ITAA 1997 Subdiv 355-G
- ITAA 1997 355-305
- ITAA 1997 355-315
- ITAA 1997 355-480
- ITAA 1997 Subdiv 355-J
- ITAA 1997 355-520
- ITAA 1997 355-525
- ITAA 1997 355-580
- TAA 1953

Case references:

- *Industry Research and Development Board v Phai See Investments Pty Limited* [2001] FCA 532
- *Federal Commissioner of Taxation v. Rothmans of Pall Mall (Aust) Ltd* (1992) 37 FCR 582; 92 ATC 4508; (1992) 23 ATR 620
- *FC of T v. Snowden & Willson Pty Ltd* (1958) 99 CLR 431
- *Magna Alloys and Research Pty Ltd v. FC of T* 80 ATC 4542; (1980) 11 ATR 276
- *Cuthbertson and Richards Sawmills Pty Ltd v. Thomas* (1999) 93 FCR 141
- *R v. Portus; Ex parte Federated Clerks Union of Australia* (1949) 79 CLR 428
- *Federal Commissioner of Taxation v. Robinson* 92 ATC 4424; (1992) 23 ATR 364

ATO references

NO:	1-3N3KMMR
ISSN:	1445-2014
ATOlaw topic:	Income Tax ~~ Deductions ~~ research and development expenses