IT 2429 - Income tax : advance payment of grant or subsidy

TAXATION RULING NO. IT 2429

INCOME TAX : ADVANCE PAYMENT OF GRANT OR SUBSIDY

F.O.I. EMBARGO: May be released

REF N.O. REF: 87/4504-8 DATE OF EFFECT:

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1206472	GRANT OR SUBSIDY - ADVANCE PAYMENT	25(1) 26(g)

PREAMBLE In a decision reported as 18 ATR Case 20; Case U7, 87 ATC 127 the Administrative Appeals Tribunal concluded that an advance payment made to a taxpayer by the Australian Industrial Research and Development Incentives Board (the Board) was assessable income on an "earnings" basis rather than assessable income in the year of receipt as contended by this office.

FACTS 2. The Board agreed to make available to the taxpayer a project grant under the provisions of the Industrial Research and Development Incentives Act 1976. The grant was to reimburse the taxpayer for half of the expenditure incurred on a specified research project. The terms of the grant required that the taxpayer submit, at the end of each financial year, a report on the technical progress of the project giving details of the expenditure incurred. The Board would then authorise the payment of an amount equal to half the eligible expenditure incurred.

3. In October 1979 the Board made a payment of $150,000 as an advance of the grant which would become payable to the taxpayer. The advance was made on the basis that it would be repayable if the project was not subsequently proceeded with to the extent attributable to the payment.

4. At 30 June 1980 it was agreed that the taxpayer had incurred expenditure on the research project to the extent to which it was entitled to a payment of $73,874. It was not disputed that this amount constituted assessable income of the taxpayer for that year. The Tribunal was asked to consider whether the balance of the advance payment ($76,126) should also be included in the taxpayer's assessable income for that year.

5. In taking the decision to include the full amount of $150,000 in the taxpayer's assessable income this office recognised that the matter was not free from doubt. There were arguments both ways. In support of the assessment the substance of the argument was that the amount of $150,000 had come home to the taxpayer, i.e. it had been paid to enable the taxpayer to proceed with the particular project. In the event that the taxpayer subsequently might have to repay some or all of the

amount an income tax deduction would be allowed for the amount repaid.

6. In support of the assessment reference was made to Smart v. Lincolnshire Sugar Co. Ltd. 20 TC 643. As appears in the Tribunal decision that was a case in which payments of what were referred to in the relevant legislation as advances were made to a sugar manufacturer but, because the price of sugar had fallen very low, they were unable to pay to the farmers from whom they bought sugarbeet a price which made it worthwhile for the farmers to grow that crop. Legislation was, therefore, enacted providing for "weekly advances" to be paid to the manufacturers for one year; the purpose of the legislation was to enable the manufacturers to pay a reasonable price to the farmers. The advances were not to be repayable by any manufacturer unless either the price of sugar rose above a specified figure, in which case the amounts of the advances were to be recovered from future subsidy payments, or the manufacturer ceased to carry on business.

7. In reaching its conclusion the Tribunal distinguished the Lincolnshire Sugar case on the basis that the payments to the sugar manufacturers were not prepayments of a grant or subsidy - they were the actual subsidy. They would only be set off against other subsidies payable later if the price of sugar rose. Unlike the advance paid to the taxpayer in the present case the advances to the sugar manufacturers were paid weekly in order to supplement their trading receipts and so enable them to maintain their trading solvency.

8. The Tribunal also referred to Arthur Murray (NSW) Pty. Ltd. v. FCT (1965) 114 CLR 314 where it was held that a prepayment under a contract for future services was liable to tax on an "earnings" basis. Although the Tribunal recognised the factual difference between a prepayment of a grant and a prepayment under a contract for future services it considered that there was a close analogy between the two. In the circumstances it considered that the principles underlying the Arthur Murray case were applicable to the present case. The Tribunal noted that the taxpayer did not do in the 1980 financial year all that was required of it to earn the amount prepaid to it. It concluded that only so much of the advance of $150,000 as was "earned" during the 1980 income year was income derived in that year and that it was earned to the extent of $73,874. The balance of $76,126 would be included in the taxpayer's assessable income as and when it was earned.

RULING

9. In the circumstances of the case the decision of the Tribunal has been accepted. From a practical point of view the effectiveness of an advance payment made to reimburse expenditure would be nullified if the advance payment were liable to tax before the expenditure had been incurred. The decision may be applied in other cases where advance payments of a grant are made to reimburse projected expenditure.

COMMISSIONER OF TAXATION
9 July 1987