IT 2598 - Income tax : foreign tax credit system : treatment of export market development grants and relevant expenses for purposes of foreign loss quarantining

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This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

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TAXATION RULING NO. IT 2598

INCOME TAX : FOREIGN TAX CREDIT SYSTEM : TREATMENT OF EXPORT MARKET DEVELOPMENT GRANTS AND RELEVANT EXPENSES FOR PURPOSES OF FOREIGN LOSS QUARANTINING.

F.O.I. EMBARGO: May be released

REF N.O. REF: L88/433-2 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1012173	FOREIGN TAX CREDIT SYSTEM AND FOREIGN LOSS QUARANTINING EXPORT MARKET DEVELOPMENT GRANTS AND RELEVANT EXPENSES	6AB(1), 25(1), 26(g), 51(1) former 51(6) & (7), 79D, 160AF(1), 160AFD

OTHER RULINGS ON TOPIC: IT 2446, IT 2508, IT 2597

PREAMBLE This Ruling addresses the position for purposes of the foreign loss quarantining provisions of the Income Tax Assessment Act 1936 ("the Assessment Act") of expenses incurred by resident taxpayers in establishing or developing export markets and of grants paid under the Export Market Development Grants Scheme (EMDGS) in respect of those expenses. It should be read in conjunction with Taxation Ruling No. IT 2597, which identifies the foreign loss quarantining provisions and clarifies their general operation.

2. An issue upon which clarification has been sought with respect to the EMDGS is whether items of expenditure in respect of which EMDGS payments are made and which qualify as allowable deductions are necessarily subject to the foreign loss quarantining provisions. Another is whether the EMDGS payment would qualify as a class of "foreign source" income in those circumstances for purposes of the foreign loss quarantining provisions, against which those expenses may be offset.

3. The Australian Trade Commission (AUSTRADE) is responsible for administration of the EMDGS under the Export Market Development Grants Act 1974. Grants paid under the EMDGS are available to Australian residents who incur eligible expenditure in seeking out and developing overseas markets for goods, specified services, industrial property rights and know-how to be exported or supplied by the Australian resident.

4. Generally speaking, the expenditure involved would qualify as an allowable deduction under subsection 51(1) of the Assessment Act. However, the types of expenditure that qualify for a grant may include categories of capital expenditure not eligible for deduction under that subsection. The grants are

considered to be income of the recipient, being received in or in relation to the carrying on of a business, and are required to be brought to account as assessable income under the provisions of subsection 25(1) and paragraph 26(g) of the Assessment Act.

RULING

5. The EMDGS basically provides for financial incentives in the form of taxable cash grants, to offset the costs incurred by Australian resident taxpayers in seeking out and developing export markets. Given that situation, it is accepted that an EMDGS grant should be treated as income attributable to the relevant export market business.

6. It follows that where relevant expenditure incurred by the taxpayer in relation to that business is treated (in accordance with Taxation Ruling No IT 2597) as subject to the foreign loss quarantining provisions of the Assessment Act, the EMDGS grant would be accepted as a class of income derived from a "foreign source", against which the relevant expenditure may be offset in the same or a subsequent year of income, as the case may be, under those provisions.

7. Where an EMDGS grant is paid in respect of an export market business carried on by the taxpayer in more than one country, the grant should be allocated to the separate "foreign sources" proportionately for foreign loss quarantining purposes. That allocation should be consistent with the basis used to allocate the relevant expenditure between the respective "foreign sources" - see paragraph 12 of Taxation Ruling No. IT 2597.

8. Given, however, the circumstances under which an EMDGS grant is paid, it would not qualify to be taken into account as foreign income for the purposes of determining the recipient taxpayer's entitlement to a foreign tax credit in respect of other foreign income, under the general world-wide scheme of the foreign tax credit provisions (see Taxation Ruling No. IT. 2508). It fails to qualify as foreign income for that purpose by reason of the definition of foreign income in subsection 6AB(1) of the Assessment Act, i.e., it is not income derived from sources in a foreign country or countries within the meaning of that subsection - see paragraphs 27 to 29 of Taxation Ruling No. IT 2597. An EMDGS grant would, therefore, represent an exception to the general rule expressed in paragraph 28 of that Ruling that income that is subject to foreign loss quarantining could be expected to also qualify as foreign income for assessment and foreign tax credit purposes.

COMMISSIONER OF TAXATION
28 June 1990