



# ***PR 1999/101 - Income Tax: Australian Biotechnology Joint Venture No 1***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *17 November 1999*



## Product Ruling

### Income tax: Australian Biotechnology Joint Venture No 1

Contents	Para
What this Product Ruling is about	1
Date of effect	11
Withdrawal	13
Previous Rulings	14
Arrangement	15
Ruling	36
Explanations	42
Detailed contents list	66

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

## No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities in future years to confirm the arrangement has been implemented as described below and to ensure that participants in the arrangement include in their income tax returns income derived in those future years.

## Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

## What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person, who takes part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Australian Biotechnology Joint Venture No 1, or just simply as 'the Project' or the 'product'.

### Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - section 8-1 of the ITAA 1997;
  - section 70-35 of the ITAA 1997;
  - section 79D of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - section 82KL of the ITAA 1936;
  - section 82KZM of the ITAA 1936; and
  - the relevant provisions of Part IVA of the ITAA 1936.
3. This Ruling does not deal with the consequences or effects of the Goods and Services Tax or any associated 'A New Tax System' legislative reforms, including the proposed changes announced as part of The New Business Tax System or their effect on the various Income Tax Acts (including the provisions set out above).
4. On 21 September 1999, the Government announced a number of changes to the tax system as part of the New Business Tax System. A number of those changes could affect the tax laws dealt with in this Ruling. On 11 November 1999 the government announced further changes, some of which could also affect the tax laws dealt with in this ruling, especially those to do with 'tax shelters'. Some of those changes apply from the dates of announcement and others are proposed to apply from nominated dates in the future.
5. This Ruling does not deal with the announced changes. We cannot rule on those changes until the relevant legislation is enacted.

### Class of persons

6. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this

Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'BioResearchers'.

7. The class of persons to whom this Ruling applies does not include persons who are associates (in terms of section 82KH of the ITAA 1936) of the entities involved in the arrangement. The class of persons also does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

8. **Precise arrangement:** the Commissioner rules on the precise arrangement identified in the Ruling.

9. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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### **Date of effect**

11. This Ruling applies prospectively from 17 November 1999, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income

# PR 1999/101

year to which it relates has not yet commenced, this Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2002. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## Previous Rulings

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14. This Ruling applies to the Project that was ruled on in Product Ruling PR 1999/68. PR 1999/68 is now withdrawn on and from the date this Ruling is made. Minimum subscription was not reached for the Project by 30 June 1999 and the former Ruling has no application at all.

## Arrangement

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15. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for a Product Ruling dated 30 September 1999, received from Court and Co on behalf of ARG Management Limited ('the Responsible Entity');
- Prospectus dated 1 June 1999 to be reissued in respect of the Australian Biotechnology Joint Venture No 1 (ARSN 087 659 505);
- **Management Agreement** between ARG Management Limited (as the Responsible Entity), Ag-Gene Australia Limited (as 'the Operational Manager') and the BioResearcher;
- **Draft Application Form and Power of Attorney** appointing ARG Management Limited as attorney for the purpose of entering into the Management

Agreement (with ARG Management Limited) on behalf of BioResearchers;

- Research Development and Commercialisation Agreement between Ag-Gene (Australia) Limited and the Queensland Department of Primary Industries in relation to the use of research facilities and related Research and Development ('R&D') work;
- Australian Biotechnology Joint Venture No 1 Constitution; and
- Australian Biotechnology Joint Venture No 1 Compliance Plan.

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

For the purpose of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a BioResearcher, or any associate (within the meaning of section 318 of the ITAA 1936) will be a party to, except agreements concerning the provision of finance that come within paragraphs 32 and 33 below. The documents highlighted are those that BioResearchers enter into. The effect of these agreements is summarised below.

16. This arrangement is called the Australian Biotechnology Joint Venture No 1. Participants are invited by the Manager to conduct a business of biotechnology research and development. Participation in the venture will include:

- the opportunity for each BioResearcher to subscribe for Royalty Participation Rights from the Manager;
- the BioResearcher enters into a 'Management Agreement' to manage and perform the Research and Development programme, and incurs:
  - ♦ a fee of \$5,200 comprised of \$425 for the two year licence of the core technology, marketing and management expenses of \$900 in the first year and \$700 in the second year, and research fees of \$1,875 in the first year and \$1,300 in the second year; and
  - ♦ an administrative fee of \$125 in year three onwards, uplifted by movements in the All Groups Consumer Price Index.

17. The Manager proposes to issue up to 2,000 Royalty Participation Rights. The minimum subscription is 300 Royalty Participation Rights to be subscribed for and funds received by the Responsible Entity within twelve months of the date of the Prospectus. Once minimum subscription has been reached the Project will commence. **This Ruling does not apply to any arrangement in which this minimum subscription is not reached.** Possible projected returns from the Project are outlined on page 13 of the Prospectus. These depend upon a range of assumptions made by the Manager. There is no assurance or guarantee whatsoever in respect of the future success of, or financial returns associated with the Project. Based on the assumptions, the Manager forecasts that a BioResearcher could expect to achieve an internal rate of return of 53%.

### **Fees Payable in Years 1 to 3**

18. The fees payable by a participant in the Project in the first three years are:

	Year 1	Year 2	Year 3
Licence fee	\$425		
Management and Marketing fee	\$900	\$700	
Research fee	\$1,875	\$1,300	
Administration fee			\$125
<b>Total</b>	<b>\$3,200</b>	<b>\$2,000</b>	<b>\$125</b>

### **Ag-Gene Australia Limited ('the Operational Manager')**

19. Ag-Gene Australia Limited ('Ag-Gene') is the Operational Manager and was incorporated in Queensland on 6 October 1997. The members of the Board of Directors have the relevant technical and business expertise to manage the activities during the course of the Project.

20. The Operational Manager has been retained by the Responsible Entity to undertake all operations relating to the carrying out of the R&D programs, including entering into collaborative R&D arrangements with other persons and/or entities for profit, marketing the Intellectual Property ('IP') of the business for the purpose of sale and/or licensing or, if necessary, patenting the IP. In essence, licence fees or royalties (in the strict sense) will not be the main objective of the Operational Manager or of other participants in the Project.

**ARG Management Limited ('the Responsible Entity')**

21. ARG Management Ltd is the Responsible Entity and is licensed under the Corporations Law to act as a Responsible Entity for the purpose of operating projects on behalf of investors.

22. This arrangement is called the Australian Biotechnology Joint Venture No 1 and has been registered as a managed investment scheme (ARSN 087 659 505) under the Corporations Law.

23. The Project involves the undertaking of biotechnological R&D by the BioResearchers, initially as individual licensees of IP, to discover and develop new or improved technologies and to exploit such biotechnical know-how by entering into contractual arrangements with others, with a view to profit. These arrangements will focus on collaborative ventures in which revenue will be generated from collaboration fees, success fees, licence fees and proceeds from the outright sale of IP.

24. A further source of revenue is the production and sale, for the Australian market, of transgenic fish. This is considered feasible by Ag-Gene, in view of the facilities that are available to the Project at the Aquaculture Research Centre located at Bribie Island in Queensland.

25. In December 1997 the Operational Manager entered into an agreement with the Queensland Department of Primary Industries ('DPI') to take over work previously done on various projects that relate to the technological outcomes sought by the promoters of the Project. Also, the agreement with the DPI allows the Operational Manager full use of the DPI's research facilities at the Queensland Agricultural Biotechnology Centre located on the campus of the University of Queensland, as well as the Bribie Island facilities mentioned above. These facilities will immediately provide the Project with access to R&D facilities with a capital value in excess of \$163 million.

26. The agreement with the DPI is for an initial term of 7 years and acknowledges that the Operational Manager will have full and unfettered rights to commercialise any IP resulting from the R&D activities conducted at the DPI facilities. Also, the DPI will not receive any royalty or other payment, other than a success fee of \$500,000 for each of the three suites of IP transferred to the Operational Manager and forming the platform for the Project. The Operational Manager will pay each of these success payments out of its own resources, after payment of the profit share due to BioResearchers, being 10% of gross revenues derived by the Project.

27. The Operational Manager will provide the BioResearchers full access to the benefits of the agreement with the DPI to undertake R&D activities. For use of its research facilities, the DPI charges a



fee of cost, as defined in the agreement at subparagraph 5.1(b), plus 15% for DPI personnel employed on R&D activities and a flat usage fee of \$370 per month per employee of the Operational Manager (or other personnel engaged in R&D work on behalf of the Operational Manager) working in the DPI facilities. These costs will form part of the costs of the Project and will be funded from proceeds received from participating BioResearchers.

28. The Project has a term of ten years, during which time the BioResearcher will carry on the business of R&D by expending the R&D funds to achieve the desired technical objectives for the purpose of commercial exploitation. At the conclusion of the Project the BioResearchers will become entitled on a fractional basis to a 10% share of any residual IP remaining. However, because the Project assets are to be disposed of at the conclusion of the Project, the Operational Manager intends to acquire (at independent valuation) any interest that the BioResearchers may have in residual IP at that time.

29. It may be possible, subject to BioResearcher agreement, that the residual IP may be transferred to another entity to be held for their benefit. In view of the number of investors, it is more likely that they would agree to dispose of their respective interests in any residual IP to the Operational Manager, as mentioned above, on the basis that the BioResearchers entering the Project are doing so for the potential income flow during the life of the Project rather than for the purpose of acquiring a capital asset. In any event, any rights that the BioResearchers will have in any residual IP will be disposed of at the end of the Project.

### **Management Agreement**

30. BioResearchers contract with the Responsible Entity to carry out the day to day operations and duties of the business of biotechnological Research and Development, including all commercialisation of the IP, as defined in the Constitution. Under the terms of the agreement, the Responsible Entity is to be paid the following amounts by each BioResearcher per Royalty Participation Right:

On or before 30 June 2000:

- \$425 the acquisition of the licence for the use of Intellectual Property (for 2 years);
- \$1,875 Research Fee (for 12 months); and
- \$900 Management Fee (for 12 months).

On or before 30 June 2001:

- \$1,300 Research Fee (for 12 months); and

- \$700 Management Fee (for 12 months).

In subsequent years:

- \$125 Administration Fee.

(This fee is expected to be paid from income accruing to BioResearchers after year two.)

### **Establishment of business**

31. Under the Management Agreement the business commences on the settlement date (cl 2.1); however, this is subject to the minimum subscription of 300 Royalty Participation Rights being met.

### **Derivation of income**

32. The main focus for generating revenue during the course of the Project will be in the area of collaborative projects on a 'fee for service' basis, which could also involve substantial 'milestone' success fees. As well, it is envisaged that fees will also be generated through the sharing of technical know-how and outright disposal of any IP that may result from undertaking R&D.

33. Although there may, from time to time, be situations whereby Intellectual Property will be created that could be patented and licensed, it is not the predominant means by which revenue is to be generated for the benefit of the participants in the Project. The same can be said for any royalties that may be generated through royalty agreements that may be entered into should a product be manufactured by major pharmaceutical or agricultural companies. The preferred course is to secure the greatest revenue during the life of the Project, rather than seeking to secure a capital asset at the end of the Project which, in view of the rapid pace of technological change in biotechnology, may well render any residual IP obsolete. **This Ruling does not apply to arrangements in which income by way of licence fees or royalties is derived from any capital assets brought into existence during the course of the Project.** If this does occur, BioResearchers may need to apply for private rulings on the tax consequences.

### **Finance**

34. No entity associated with the Project is involved in the provision of finance for the Project. No agreement exists between ARG, Ag-Gene or any associated entity or non-associated entity that may be involved in the Project, to deposit funds as security or

# PR 1999/101

otherwise with any person providing finance to any BioResearcher in the Project.

35. This Ruling only applies to loan agreements that exhibit the following features:

- all loan terms are of an arm's length nature;
- borrowers will remain fully liable for the balance of the loan outstanding at any time, and lenders will take full legal action against any defaulting borrowers;
- none of the funds lent will be transferred, either directly or indirectly, back to the lender, or any associate, as part of any 'round robin', or equivalent, transaction;
- the loan will not be a 'split loan', of the type described in Taxation Ruling TR 98/22;
- there will be no indemnity, or equivalent, agreement to reduce the borrower's liability;
- repayments of principal and payments of interest will not be linked to derivation of income from the Project, and will be made regularly, commencing from, or about, the time of the making of the loan; and
- insufficient 'additional benefits' will be granted to borrowers for the purposes of section 82KL and the funding arrangements will not be used to transform the Project into a 'scheme' to which Part IVA applies.

## Ruling

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36. For a BioResearcher who is accepted in the Project by 30 June 2000 and incurs the fees set out in paragraph 28, the following deductions will be available for the years ended 30 June 2000 to 30 June 2002:

**PR 1999/101**

FOI status: may be released

Page 11 of 19

		Deductions available each year		
		Year 1	Year 2	Year 3
Year ended		30/6/2000	30/6/2001	30/6/2002
Fee type	ITAA 1997 section			
<b>Licence fee</b>	8-1	\$425 (see note below)		
<b>Management and Marketing fee</b>	8-1	\$900	\$700	
<b>Research and Development fee</b>	8-1	\$1,875	\$1,300	
<b>Administration fee</b>	8-1			\$125
<b>Interest on loan</b>	8-1	as incurred	as incurred	as incurred

**Note:**

As the licence fee is under \$1,000 it is excluded expenditure for the purposes of section 82KZM and, as such, the expenditure will not need to be apportioned over the two years to which it relates.

37. For a BioResearcher who invests in the Project between 1 July 2000 and 30 June 2001 and incurs the amounts described in paragraph 34 above, the deductions available to them for the year ended 30 June 2001 will be as detailed above for year one, and for the year ended 30 June 2002 will be detailed above for year two. For a BioResearcher who invests in the Project between 1 July 2001 and 30 June 2002 and incurs the amounts as described in paragraph 34 above, the deductions available to them for the year ended 30 June 2002 will be as detailed above for year one.

**Section 79D**

38. If deductions relate to the derivation of a class of assessable foreign income then section 79D of the ITAA 1936 will limit the deduction to the amount of that class of assessable foreign income. The definition of a 'class of assessable income' has the same meaning as in section 160AFD of the ITAA 1936.

**Section 70-35**

39. Where intellectual property is considered to be trading stock, then the excess of the value at the end of the income year over the value at the start of the income year is to be included in the assessable income of the BioResearcher.

## Sections 82KZM and 82KL; Part IVA

40. For a BioResearcher who invests in the Project the following provisions of the ITAA 1936 have application as indicated:

- the expenditure by BioResearchers does not fall within the scope of section 82KZM;
- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## Income

41. For a BioResearcher who invests in the Project, any income derived by them from the sale of Intellectual Property, receipt of collaborative research fees, success fees and any other fees will be assessable income to them under section 6-5.

## Explanations

### Section 8-1

42. Consideration of whether research, management, marketing, administration and licence fees are deductible under section 8-1 proceeds on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred when the business has not commenced; and
- where all that happens in a year of income is a taxpayer contractually commits to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the paragraph 8-1(1)(b) applies. However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with activities engaged in with a view to producing assessable income.

43. Biotechnological R&D activities outlined above can constitute the carrying on of a business. Where there is a business, or a future

business, the gross proceeds from collaboration fees, success fees, and sale or licensing of IP (and possibly royalties) derived as a result of the business activities, will constitute gross assessable income.

44. The generation of 'business income' from such business activities, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite nexus with the operations that more directly gain or produce this income. These operations will be the undertaking of biotechnological R&D to discover and add to the knowledge base currently possessed by the co-venturers for the purpose of developing new technologies for commercial exploitation through collaborative ventures and co-development with third parties. This may include collaboration fees, success fees in the form of 'milestone' payments as well as licensing and/or sale of the IP, where appropriate, having regard to the commercial considerations existing at the time. However, the intention of the Operational Manager is not to seek to create a capital asset at the end of the Project but rather to exploit, on an ongoing basis, any technical know-how acquired by the Project team.

45. Generally, a BioResearcher will be carrying on a business of biotechnological R&D where:

- the investor has an identifiable interest in specific IP through a licence agreement and uses that right to develop and acquire scientific knowledge for the purpose of exploitation through collaborative ventures with third parties and through the possibility of licensing agreements, as well as from revenue generated from the sale of products such as transgenic fish;
- the biotechnological R&D activities are carried out on the investor's behalf; and
- the weight and influence of the general indicators of a business, as used by the Courts, point to the carrying on of a business.

46. For the Project, BioResearchers have, under the terms of the Management Agreement, identifiable rights in the form of a licence over IP and rights to the use of R&D facilities, which are consistent with the intention to carry on a business of biotechnological R&D. Under the Management Agreement BioResearchers appoint the Responsible Entity to manage, on their behalf, their interests in the biotechnological R&D business.

47. Under a power of attorney, a BioResearcher authorises the Project Manager to enter into the Management Agreement on their behalf. The BioResearchers' rights under the Management Agreement are protected by reason of the obligations placed on the

# PR 1999/101

Responsible Entity through, among other things, the Compliance Committee, which must report to the ASIC any suspected contravention of the Corporations Law. Also, the Responsible Entity is bound by the provisions of the Management Agreement and those of the Constitution.

48. Furthermore, under the Corporations Law, the BioResearchers in the Project can, by a vote of 50% or more of all the BioResearchers, remove the Responsible Entity if it fails to perform its proper role as operator of the Project.

49. As part of its obligations the Responsible Entity will send a half yearly report to all BioResearchers on work performed under the R&D program during the preceding six months. The report will set out results achieved during the period, projected expenditure for the next six months, a summary of any IP that resulted during the period and any recommendations by the Responsible Entity in respect of the ongoing R&D.

50. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. BioResearchers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Draft Prospectus that suggest the Project should return a 'before-tax' profit to the BioResearchers, i.e., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a tax deduction. These projections have been confirmed as realistic by an independent biotechnology consultant.

51. BioResearchers will engage the professional services of the Operational Manager. The Operational Manager has the requisite expertise to perform the relevant management and scientific related services on behalf of the BioResearchers and is able to secure the services of other highly skilled scientists to carry out biotechnological R&D in order to maximise the potential for successful outcomes for the Project.

52. The services outlined above are based on accepted biotechnological R&D practices carried out in the scientific field to bring technology to a stage of commercialisation and, as such, would commonly be said to constitute a business.

53. On entering the Project, BioResearchers have a continuing interest in a share of the revenues during the life of the Project (i.e., 10% of gross revenues). Also, at the end of the Project, the BioResearchers will become entitled to a 10% equity in any residual IP remaining at that time. This equity must be converted into cash at the end of the Project and it is envisaged that the Operational Manager will buy out each of the BioResearchers' equity in the IP at market

valuation. It is unlikely that BioResearchers will seek to keep any IP, i.e., by having their interests transferred to another entity on their behalf. The reason for this view is because the purpose of each BioResearcher investing in the Project is to maximise revenue rather than to acquire a capital asset. Also, the large number of investors involved would make it impractical to hold such property as a long-term proposition.

54. The biotechnological R&D activities to be conducted, and hence the fees associated with their procurement, are consistent with the intention to commence regular activities that have an 'air of permanence' about them. The BioResearchers' biotechnological R&D activities will therefore constitute the carrying on of a business.

55. The fees associated with the biotechnological activities will relate to the gaining of income from this business and, hence, have a sufficient nexus to the operations by which this income (from the exploitation of the IP, for example, collaborative fees, success fees, licence fees, sale of product, etc.) is to be gained from this business. They will, thus, be deductible under the first limb of section 8-1. Further, no 'non-income' producing purpose in incurring the fees is identifiable from the arrangement. The fees appear to be reasonable. No capital component is identifiable in the first two years of the Project. The tests of deductibility under the first limb of section 8-1 are, therefore, met and the exclusions to the section do not apply.

### **Expenditure of a capital nature**

56. Any part of the expenditure of a BioResearcher entering into the business of research and development that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. Where Intellectual Property is developed for the use of a BioResearcher in the gaining of royalties or licence fees, the expenditure incurred in the development of that Intellectual Property is of a capital nature and will not be deductible under section 8-1. If the receipt of royalties and licence fees is merely incidental to the sale of the Intellectual Property then the expenditure incurred in the development of that Intellectual Property will not be excluded from deductibility under section 8-1.

### **Section 82KZM**

57. A licence fee of \$425 is payable by BioResearcher for the use of existing Intellectual Property for a period of two years from the date of entering into the arrangement. As the expenditure under the agreement is less than \$1,000 it is 'excluded expenditure' under



section 82KZL and, as such, is excluded from the operation of section 82KZM by virtue of subparagraph 82KZM(1)(b)(ii).

58. No conclusion can be drawn from the arrangement's description, that other fees payable have been inflated to result in reduced fees being payable for subsequent years. There is no evidence that might suggest the services covered by the fees could not be provided within 13 months of incurring the expenditure in question. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditures identified above in each of the financial years ended 30 June 1999 to 30 June 2001.

### **Section 82KL**

59. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

60. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is, essentially, the tax saved if a deduction is allowed for the relevant expenditure.

61. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

### **Part IVA**

62. For Part IVA to apply there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a 'dominant purpose' of entering into the scheme to obtain the tax benefit (section 177D). The Project will be a 'scheme', commencing when the Prospectus is issued.

63. The BioResearchers will obtain a 'tax benefit' from entering into the scheme, in the form of deductions for management and marketing fees, research and development fees, licence fees and administration fees within the three years to which the Ruling relates. These fees are deductible under section 8-1. The resultant tax benefit would not have been obtained but for the scheme. However, it is not

possible to conclude that the scheme will be entered into or carried out for the dominant purpose of obtaining this tax benefit.

64. BioResearchers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the eventual marketing of IP obtained through carrying out structured biotechnological R&D. Further, there are no features of the Project, for example, such as the relevant fees being ‘excessive’, and uncommercial, and predominantly financed by way of a non-recourse loan, that might suggest the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA. Accordingly, Part IVA does not apply to participants in the Project.

#### **Assessable income**

65. Gross sale proceeds derived from the sale of intellectual property, collaborative research and development fees, success fees or any other fees will be assessable income of the BioResearchers, under section 6-5, in the year in which a recoverable debt accrues to them. This will depend on the specific contracts entered into.

### **Detailed contents list**

66. Below is a detailed contents list for this Ruling:

	<b>paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Class of persons	6
Qualifications	8
<b>Date of effect</b>	<b>11</b>
<b>Withdrawal</b>	<b>13</b>
<b>Previous Rulings</b>	<b>14</b>
<b>Arrangement</b>	<b>15</b>
Fees Payable Years 1 to 3	18
Ag-Gene Australia Limited (‘the Operational Manager’)	19
ARG Management Limited (‘the Responsible Entity’)	21
Management Agreement	30
Establishment of business	31
Derivation of income	32

# PR 1999/101

Finance	34
<b>Ruling</b>	<b>36</b>
Section 79D	38
Section 70-35	39
Sections 82KZM and 82KL; Part IVA	40
Income	41
<b>Explanations</b>	<b>42</b>
Section 8-1	42
Expenditure of a capital nature	56
Section 82KZM	57
Section 82KL	59
Part IVA	62
Assessable income	65

## Commissioner of Taxation

17 November 1999

*Previous draft:*

No draft issued

- tax shelters project

*Related Rulings/Determinations:*

TR 92/1; TR 92/20; TR 97/11;  
TR 97/16; TR 98/22; TD 93/34

*Legislative references:*

- ITAA1936 79D
- ITAA1936 82KH
- ITAA1936 82KH(1)
- ITAA1936 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZL
- ITAA1936 82KZM
- ITAA1936 82KZM(1)(b)(ii)
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1936 160AFD
- ITAA1997 6-5
- ITAA1997 8-1
- ITAA1997 8-1(1)(a)
- ITAA1997 8-1(1)(b)
- ITAA1997 70-35

*Subject references:*

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- research and development
- intellectual property
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance schemes
- tax shelters

*Case references:*

# PR 1999/101

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FOI status: may be released

Page 19 of 19

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