


TR 2013/3A2 - Addendum - Income tax: research and development tax offsets: feedstock adjustments

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Addendum

Taxation Ruling

Income tax: research and development tax offsets: feedstock adjustments

This Addendum is a public ruling for the purposes of the *Taxation Administration Act 1953*. It amends Taxation Ruling TR 2013/3 to clarify the Commissioner's view of the law following the decision in *GHP 104 160 689 Pty Ltd v. Commissioner of Taxation*.¹

TR 2013/3 is amended as follows:

1. Paragraph 9

In the table, at the end of the definition of feedstock outputs, insert footnote 9A:

^{9A} There is an inherent link between feedstock outputs and feedstock inputs, since a feedstock output is produced from feedstock inputs and this results from transformation or processing of those inputs. See paragraphs 18A to 18C of this Ruling for more detail.

2. Paragraph 18

(a) After the paragraph, insert:

18A. It is noted that there is an inherent link between feedstock inputs and feedstock outputs. This relationship is reflected in the distinction between:

- those goods or materials which *are themselves* transformed or processed during R&D activities, and
- those which are merely acquired or produced to subject *other* goods or materials to transformation or processing during such activities.

18B. In this context, a feedstock input will *itself* be transformed or processed where it continues to exist, in some form, in the output being produced. The provisions necessarily contemplate that inputs will be transformed or processed during R&D activities. Therefore, it is not a requirement that the feedstock input exist in the feedstock output in its original form. Nor is it a requirement that *all* of the feedstock input form part of the feedstock output. Once it is identified that the feedstock input continues to exist in the output being produced, other than in the form of a trace amount or as unwanted residue^{19B}, the full amount of the expenditure on the feedstock input is feedstock input expenditure. This is the case, even though part of the feedstock input may not be present in the feedstock output.

¹ [2014] AATA 515; 2014 ATC 10-373.

18C. In contrast, a feedstock input will not *itself* be transformed or processed where it does not exist (in any form) as part of the output, or is only present in that output in trace amounts or as unwanted residue.

- (b) After 'residue' in new paragraph 18B, insert footnote 19B:

^{19B} These things can be disregarded on the basis that their amount or value is so trifling as to be negligible; *Wilkes v. Goodwin* 143 [1923] 2 KB 86; [1923] All ER 61.

3. Paragraph 85

In footnote 42, omit 'tdhey', substitute 'they'.

4. Paragraph 113

- (a) After the paragraph, insert:

Example 5 – transformation of feedstock input forming part of tangible product

113A. *Copper Co Pty Ltd is an R&D entity that undertakes R&D activities in its copper refining process which results in the production of tangible products. As part of its R&D activities it acquires oxygen which is then used in the R&D activities where the oxygen reacts with copper sulphide and sulphur in the process to create copper and sulphur dioxide.*

113B. *The sulphur dioxide comes off as a gas. The sulphur dioxide produced is collected and delivered to a third party to be used for that third party's commercial purposes. It is a product. Oxygen forms part of that product. Accordingly the expenditure on the acquisition of oxygen used in these R&D activities is incurred in acquiring goods transformed or processed by the Copper Co during R&D activities in producing a tangible output, the sulphur dioxide. It does not matter that only part of the oxygen input into the process forms part of the new product, or that the oxygen now exists in the form of sulphur dioxide.*^{42A}

Example 6 – feedstock input not part of tangible product

113C. *Zinc Co Pty Ltd is an R&D entity that undertakes R&D activities in its zinc refining process, resulting in the production of zinc concentrate.*

113D. *Part of this process involves floating unrefined zinc in water, and later adding flocculants to bring the zinc particles together. The flocculants remain in the concentrate but naturally decompose once it dries. Therefore, they are not part of Zinc Co's feedstock output.*

113E. *Zinc Co also uses explosives, compressed air, lubricants, anti-scalant, welding gases and batteries as part of the zinc concentration process. These materials do not form any part of the zinc concentrate produced and are not therefore transformed or processed into outputs for the purposes of the feedstock provisions.*^{42B}

- (b) At the end of new paragraph 113B, insert footnote 42A:

^{42A} *GHP 104 160 689 Pty Ltd v. Commissioner of Taxation* [2014] AATA 515; 2014 ATC 10-373.

- (c) At the end of new paragraph 113E, insert footnote 42B:

^{42B} *GHP 104 160 689 Pty Ltd v. Commissioner of Taxation* [2014] AATA 515; 2014 ATC 10-373.

5. Paragraph 154

- (a) After the paragraph, omit the heading '*The importance of the relationship between the first and second conditions*'; substitute:

154A. The discussion in paragraphs 132 to 154 of this Ruling shows that the word 'in' has a wide meaning in this context, and that the first condition is concerned with whether the R&D entity has incurred expenditure of a particular character. The character is determined both by the breadth of the meaning of the word 'in' in the first condition and the relationship between the first and second conditions.

The importance of the relationship between the first and second conditions

154B. The language of paragraph 355-465(1)(a) and paragraphs 355-465(1)(b) and 355-465(2)(b) reflects the inherent link between feedstock inputs and feedstock outputs. This link provides guidance on how to distinguish between goods or materials which are *themselves* transformed or processed during R&D activities and those which subject *other* goods and materials to transformation or processing.

154C. Paragraph 355-465(1)(a) demonstrates the link^{65A} required between the feedstock inputs and the feedstock outputs. That is, the transformation or processing of feedstock inputs results in the production of one or more tangible products, the feedstock outputs. Paragraph 355-465(2)(b) then refers to the amounts referred to in paragraph 355-465(1)(b) and the amounts reasonably attributable to the production of the feedstock outputs. Where the ingredients or raw materials continue to exist in some form in the final product they would meet the requirements of being feedstock inputs for the purposes of Subdivision 355-H regardless of whether all of the feedstock input exists in the final output.

- (b) After 'link' in new paragraph 154C, insert footnote 65A:

^{65A} *GHP 104 160 689 Pty Ltd v. Commissioner of Taxation* [2014] AATA 515; 2014 ATC 10-373 (*GHP*) at paragraphs 197-198, in relation to former section 73B of the ITAA 1936.

6. Paragraph 155

Omit the paragraph, substitute:

155. Once it has been identified that the R&D entity has incurred expenditure of a particular character the first condition does not require a calculation of the expenditure it refers to. Rather, it interacts with the second condition and subsection 355-465(2) which concerns the calculation of the feedstock adjustment. This is because the first part of the second condition asks whether the R&D entity has notionally deducted an amount 'for the expenditure', being the expenditure referred to in the first condition.

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7. Paragraph 252

(a) After paragraph 102, insert:

Example 5 – transformation of feedstock input forming part of tangible product 113A

Example 6 – feedstock input not part of tangible product 113C

(b) Omit '155'; substitute '154B'.

8. Subject references

Omit all subject references, including the heading.

This Addendum applies on and from 1 July 2014.

Commissioner of Taxation

20 February 2019

ATO references

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