CR 2012/110 - Income tax: research and development tax concession: membership funding for the ACA Low Emissions Technologies Program

Class Ruling

Income tax: research and development tax concession: membership funding for the ACA Low Emissions Technologies 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 73B of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 73C of the ITAA 1936;
- section 73L of the ITAA 1936;
- section 82KZL of the ITAA 1936;
- section 82KZMA of the ITAA 1936;
- section 82KZMD of the ITAA 1936; and
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Unless otherwise specified, all legislative references are to the *Income Tax Assessment Act 1936*.

Class of entities

3. The class of entities to which this Ruling applies comprise 'eligible companies', as defined by subsection 73B(1), who are liable for levy contributions under the ACA Low Emissions Technologies Program, and who:

- are registered for each of the relevant years of income with Innovation Australia, in accordance with subsection 73B(10) ;
- have an aggregate research and development amount as defined in subsection 73B(1) that exceeds $20,000; and
- are not a small business entity as defined in section 328-110 of the ITAA 1997.

4. In this Ruling the term 'Contributor' is used to refer to those companies that are ultimately obliged to pay contributions to ACA Low Emissions Technologies Limited (ACALET). In the Contribution Deed discussed below, those Contributors are either the 'mine owner(s)' or, where no separate 'mine owner(s)' is identified in the Contribution Deed, the 'operator(s) of coal producing assets' or 'contributor(s)'.

5. This Ruling **does not apply** to eligible companies that are not registered for the relevant years of income with Innovation Australia. The publication of this Ruling does not relieve Contributors from the obligation to make separate applications for registration of their activities under section 39J 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. This Ruling only applies to contributions used to fund the activities undertaken in accordance with the agreement entered into between ACALET and Australian National Low Emissions Coal Research and Development Ltd (ANLEC) on 3 March 2010 (Funding Agreement).

7. Further, this Ruling does not apply to any contributions made in a relevant year of income that are less than $1,000 (in total for that year of income).

8. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 12 to 60 of this Ruling.

9. 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

11. This Ruling applies from 1 July 2007 to 30 June 2011. The Ruling continues to apply after 30 June 2011 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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), or to the extent a tax law ruled on does not apply after 30 June 2011.

Scheme

12. 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:

- application for class ruling and accompanying attachments sent via email on 27 October 2011;
- letter from the applicant and accompanying attachments dated 11 November 2011;
- letter from the applicant and accompanying attachments dated 24 February 2012;
- letter from the applicant and accompanying attachments dated 9 March 2012;

- letter from the applicant and accompanying attachments dated 4 April 2012; and
- the Minutes of the meeting that took place on 11 April 2012, between representatives of the Australian Taxation Office (ATO) and the applicant.

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

Background

13. The Coal21 National Action Plan was formally issued on March 2004 by the Minister for Industry Tourism and Resources, highlighting the national challenge facing Australia with substantial greenhouse gas emission impact from fossil fuel use. The plan identified options to address the greenhouse gas emissions impact by an intensive program of research and development (R&D) and demonstration in the areas of low emissions technologies associated with the use of coal.

14. The Australian black coal industry accepted the need to arrange a new program consistent with the Coal21 National Action Plan. The ACA Low Emissions Technologies Program (ACALET Program) was established to support research, development and demonstration aimed at developing clean coal technologies. Funding for the ACALET Program is provided by way of voluntary levies.

ACALET

15. ACALET has been established to manage the ACALET Program. ACALET is not a registered research agency under section 39F of the IR&D Act 1986.

16. Clause 4 of ACALET's Constitution describes its objects, which include:

- providing for the collective and integrated research of coal for the purposes of providing strategic leadership to the coal and associated industries with particular regard to potential low emissions technologies applicable to the use of coal;
- allocating the funds raised among registered research agencies and other research agencies and demonstration project agencies chosen by the company to undertake research and/or demonstration projects;
- acting as a catalyst to stimulate research and development and demonstration project interest within the coal and associated industries;

- improving the management and application of coal research and demonstration projects in Australia;
- ensuring a more efficient use of Australia's black coal resources;
- increasing the economic, environmental safety and social benefits to the coal industry and wider community;
- promoting competitiveness, sustainable use and management of Australia's coal resources; and
- entering into contracts with and engaging organisations to manage research projects and/or demonstration projects on behalf of groups of companies.

17. Each coal producer group operating in Australia has the opportunity to become a member of ACALET. The Board of ACALET comprises of up to 15 directors.

18. Clause 6 of ACALET's Constitution governs membership of the company. In particular clause 6.10 provides that:

> [each] Member must enter into an agreement with the Company to pay contributions or levies to the Company which will be applied towards the promotion of the objects of the Company set out in clause 4.

19. As detailed in paragraph 14 of this Ruling, participation in this arrangement is voluntary. Any payments made by a Contributor under this scheme, who is also a member of ACALET, are taken to be made voluntarily, and not in its capacity as a member of ACALET.

Contribution Deed

20. Each affected coal producer (being a Contributor) enters into a Contribution Deed with ACALET under which they are liable to pay contributions (levies). Agency clauses are present in the agreement, which demonstrate that in some circumstances, the Contributor entering into the Contribution Deed on behalf of the relevant 'mine owners'.

21. The Contribution Deed sets out the rights and obligations of ACALET and the Contributor, in particular the:

- agreement to pay contributions, clause 2;
- amount of the contributions, clause 3; and
- actual payment of contributions, clause 4.

22. The Contributors agree to pay levies to ACALET in consideration for its promise that they will be applied exclusively in respect of 'research and development' and/or 'demonstration projects' as defined in the Contribution Deed and also for management and administration expenses in respect of R&D and/or 'demonstration projects'. Further, the Contribution Deed also requires that the results of the R&D will be made available to the Contributors to the extent possible, under the terms of the various agreements entered into by ACALET in relation to the ACALET Program.

23. Contributions accrued by a Contributor are calculated up to a maximum of $0.20 per tonne of coal produced by the Contributor from the coal producing assets from 30 June 2007. The Contributor must pay to ACALET the amount of contribution equal to the accrual balance (which increases by quarterly sales multiplied by the rate of contribution and decreases by any payments made), unless a payment notice has issued. If it has then the Contributor must only pay the amount on the Payment Notice. Contributions are made on a quarterly basis.

24. All contributions paid to ACALET become the property of ACALET and cannot be refunded.

25. The Contribution Deed defines R&D to mean scientific, technical or economic research in connection with the beneficiation and use of coal or products derived from coal, including the demonstration and development of the results of that research and includes:

(a) training of persons for the purpose of any such R&D;

(b) publication of reports, periodicals, books and papers in connection with such R&D;

(c) 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) matters incidental or relating to a matter referred to in this definition; and

(e) matters incidental or relating to the obligations of ACALET under the Contribution Deed including costs incurred in collection of contributions.

26. The Contribution Deed defines 'demonstration project' to mean a project with the objective of demonstrating the technical and/or commercial potential of a new low emissions technology or process, and includes the application of an existing overseas technology or process to Australian circumstances.

27. ACALET will provide expenditure statements to Contributors pursuant to clause 9(d) of the Contribution Deed. This requires that ACALET provide biannual reports to Contributors indicating the apportionment of the expenditure of contributions to R&D and demonstration projects. ACALET will also provide quarterly reports to Contributors, as it recognises that companies will have a range of tax year-end dates. The quarterly reports are derived from a 'contributor reporting spreadsheet' developed by ACALET, and set out the Contributor's percentage of the eligible research and development expenditure (R&D expenditure) and other expenditure spent on the relevant project or on related overheads for the quarter. It is intended that a Contributor's claim under section 73B, in relation to expenditure incurred to ACALET for a particular income year, should be able to be compiled by taking the appropriate details from the quarterly reports for the four quarters falling within that taxpayer's particular income year.

28. The Contribution Deed commences on the effective date and will be reviewed by the parties during the three month period expiring on 30 June 2017. It envisages continuing to the later of such date that the parties agree upon, or the date on which the accrual balance is nil, unless terminated earlier. The effective date will vary for Contributors, as some entered into the Contribution Deed prior to 30 June 2007 and some after this date.

29. The Contribution Deed 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.

30. Companies representing over 95% of black coal production capacity have committed to participate in the ACALET Program by making contributions to ACALET for the period 1 July 2007 to 30 June 2017.

31. The expenditure is not a 'pre-RBT obligation' as defined in subsection 82KZL(1).

The interaction between Australian National Low Emissions Coal Research and Development Ltd and ACALET – funding and operations

32. Contributions paid to ACALET by Contributors are (in part) used to fund the operations of ANLEC. ANLEC has been identified as a suitable vehicle through which ACALET can further the objectives of the ACALET Program due to its focus on the development of coal related technologies.

33. The Funding Agreement requires that the funds be utilised in the broad research programme undertaken by ANLEC (ANLEC Project). ANLEC is expected to continue operation for a number of years.

34. All funding provided by ACALET must be used for the sole purpose of performing the ANLEC Project. ANLEC must not use ACALET funding for any other purpose.

35. The ANLEC Project is carried out under the stewardship of ANLEC, utilising funding from two primary sources, being ACALET and the Commonwealth of Australia.

36. Under schedule 3 of the Funding Agreement, ANLEC has agreed to provide ACALET with the following reports:

- progress reports on each project, undertaking or endeavour which ANLEC funds (Eligible Project) in order to undertake the ANLEC Project, every 6 months;
- financial reports relating to the ANLEC Project annually;
- final report at the end of the ANLEC Project; and
- ad hoc reports as required upon the happening of a significant event.

37. Under clause 9 of the Contribution Deed ACALET has agreed to provide Contributors with:

- a statement indicating the apportionment of the expenditure of Contributions to Research and Development and Demonstration Projects respectively during the immediately preceding 6 month period and, each Quarter, estimates indicating the apportionment of the expenditure of Contributions to Research and Development and Demonstration Projects for the upcoming Quarter; and
- financial reports on a yearly basis ending 30 June of each year, such financial reports to be audited annually.

38. To date some reports to ACALET and statements to Contributors have been provided illustrating the apportionment of the contributions which have been received by ANLEC, and applied towards the ANLEC Project. This apportionment reflects expenditure that may give rise to a deduction for the Contributors' under section 73B, and expenditure that will not.

39. The Funding Agreement has established a supervisory body known as the Programme Review Committee (PRC). The PRC consists of three members, one of which is nominated by ACALET. The PRC has a supervisory role in relation to reviewing;

- the progress of the ANLEC Project, including the activities of each research node;
- the performance of the Research Programme;

- the draft Annual Plan submitted for each Financial Year; and to provide feedback on that Annual Plan to ANLEC;
- and providing feedback to ANLEC on the Pro Forma Funding Agreement;
- and providing feedback to ANLEC on the Pro Forma IP Deed Poll;
- the implementation of the Annual Plan supporting the ANLEC Project; and
- the performance of ANLEC under the terms of the Funding Agreement.

40. Whilst the PRC has no decision making powers, it has power to consider changes to the funding principles under the Funding Agreement.

41. In addition to supporting the functioning of the PRC, ANLEC is required to gain ACALET's approval for both:

- the Research Programme that underpins the ANLEC Project; and
- the Annual Plan that underpins the ANLEC Project.

42. As discussed in paragraph 39 of this Ruling, the PRC has a supervisory role in relation to the development of the pro-forma funding agreements and IP deed polls which form the basis of the various Eligible Project Funding Agreements entered into between ANLEC and third party researchers. The various Eligible Projects supported by each Eligible Project Funding Agreement are the constituent parts of the ANLEC Project.

43. As discussed in paragraph 34 of this Ruling, all funding provided by ACALET in accordance with the Funding Agreement must be used for the ANLEC Project. Further, the funds must be spent in accordance with the Annual Plan and associated funding principles and not paid to any other party. ACALET retains a power to direct ANLEC not to spend funds which have been paid over, but remain unspent by ANLEC at the point in time when ACALET so directs.

44. It is expected that the information detailed in the Annual Plan prepared by ANLEC will ultimately feed into the reports that ANLEC has agreed to provide to ACALET. This information will then feed into the reports which ACALET provides to its Contributors.

45. Under the terms of the Funding Agreement, ACALET may provide certain material to ANLEC for use in the ANLEC Project. This is referred to as 'ACALET Material'. ACALET may impose conditions and restrictions on the use of the ACALET Material, provided they are consistent with the Funding Agreement.

46. Intellectual property (IP) that is developed from the ANLEC Project is referred to as 'Agreement Material'. Under the Funding Agreement, ownership of any IP rights associated with the Agreement Material shall vest in ANLEC. However, in the event that the Agreement Material cannot be owned by ANLEC, then the Funding Agreement requires that ANLEC use reasonable endeavours to obtain licenses over the Agreement Material on behalf of ACALET.

47. The parties to the Funding Agreement recognise that third parties will bring pre-existing Material in the form of IP which will ultimately be utilised in the ANLEC Project. The Funding Agreement provides for ANLEC to grant licences to ACALET (and their Contributors) to allow these persons to utilise any pre-existing Material so as to enable ACALET to exploit the Agreement Material developed during the course of the ANLEC Project.

48. ANLEC is required to provide certain warranties in relation to pre-existing Material. For example, ANLEC is required to warrant that the use of this material by ACALET (or their Contributors) will not infringe the IP rights of any person.

49. As discussed in paragraph 46 of this Ruling, where possible Agreement Material will be owned by ANLEC. Contributors will not own any assets acquired in the course of the ANLEC Project, nor will they be the holder of any depreciating assets under section 40-40 of the ITAA 1997. Further, by making contributions to the ACALET Program, the Contributors are not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities.

50. Under the terms of the Contribution Deed ACALET has agreed to supply all information that it has in relation to any R&D or demonstration projects to the Contributors. However, this is subject to the terms of any agreement that ACALET may have entered into.

51. Some contributions made by the Contributors to ACALET are also used by ACALET for management and administration activities in respect of the Project.

52. Levies paid to ACALET by Contributors constitutes 'expenditure incurred' for the purposes of ascertaining entitlement to a deduction under section 73B, or a general deduction under section 8-1 of the ITAA 1997. Levies paid by each Contributor to which this Ruling applies, for each relevant income year, are $1,000 or more.

53. Contributions do not produce any enduring benefit or advantage to the Contributors, but rather are intended to assist them in marketing their product.

R&D activities

54. Low Emission Coal Technology (LECT) typically refers to one of the following technologies:

- Integrated Gasification Combined Cycle with Carbon Capture and Storage (IGCC with CCS); or
- Pulverized Coal (PC) combustion, either with Post Combustion Capture (PCC) or Oxy-Fuel.

55. LECT has not yet been widely deployed on a commercial scale. PC (without carbon capture) dominates both the world and Australian coal based power generation industries. The ANLEC Project has the primary objective of providing the data, knowledge and capability to allow rapid and low risk implementation of LECT with CCS under Australian conditions on a commercial scale.

56. Benefits of this R&D will include:

- reduced cost and time required for project developers to take a project to pre-FEED status;
- reduced cost and time required in permitting of projects
- reduced financing risk through increased knowledge and data available to owners & bankers engineers;
- reduced capital and operating cost and increased operating flexibility through tailoring of plant specifically for Australian fuels, market requirements and environmental conditions;
- reduced risks involved in using Australian fuels in commercial LECT systems, thereby supporting future marketability of those fuels;
- improved plant reliability and availability; and
- evaluation of options for step changes in cost and efficiency from second generation technologies.

57. ANLEC will focus on accelerating the feedback between the early demonstration projects and the applied technology R&D, thereby mitigating risk and accelerating the technology development cycle.

58. The R&D will be conducted across the following program areas:

(a) Capture:
- IGCC
- Oxy Fuel
- Post Combustion Capture

(b) Geosequestration;

(c) Brown Coal;

(d) Economics; and

(e) Alternatives and Fundamentals.

No research service provider or CRC contributions

59. Contributions are not expenditure incurred to a research service provider (RSP) within the meaning of the IR&D Act 1986, or a CRC under the Commonwealth Cooperative Research Centres program.

Commonwealth funding

60. The Commonwealth has entered into a separate funding agreement with ANLEC in relation to the ANLEC Project. The terms on which the Commonwealth will fund ANLEC are broadly the same as those embodied in the Funding Agreement.

Ruling

Subsections 73B(14) and 73B(9)

61. For the years of income ending 30 June 2008 to 30 June 2011 inclusive (or equivalent substituted accounting period), to the extent that contributions made in an income year are $1,000 or more and are incurred directly in respect of R&D activities as defined in subsection 73B(1), Contributors can claim a deduction under subsection 73B(14). Subsection 73B(9) will not prevent this deduction from being allowable. However, the prepayment rules discussed below, may impact on the amount and timing of any deduction available.

62. No deduction is allowable under subsection 73B(14) to a Contributor:

- for any proportion of the contributions applied to the performance of activities that do not come within the definition of 'research and development activities' (as defined in subsection 73B(1));
- for any proportion of the contributions that relate to activities for which an unfavourable certificate has been issued under sections 39L or 39S of the IR&D Act 1986;
- who is not registered with Innovation Australia, as required by subsection 73B(10) for a particular income year; or
- if that Contributor's aggregate R&D amount as defined in subsection 73B(1) is $20,000 or less.

63. The Commissioner acknowledges that any opinion formed about the R&D activities can be overridden by Innovation Australia (the Board). Therefore, the Commissioner does not express an opinion about these activities and whether they are eligible R&D activities as defined in subsection 73B(1). This Ruling is made on the presumption (unless told otherwise by the Board) that the activities are eligible R&D activities as defined under subsection 73B(1).

Section 82KZMD

64. Where expenditure deductible under subsection 73B(14) is for R&D activities to be carried on not within the expenditure year, section 82KZMD applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

Section 73C

65. Section 73C does not apply to any expenditure incurred by Contributors who are not recipients of (or their section 73L group members are not recipients of) Commonwealth grant funding. Any Contributor that is a recipient of Commonwealth funding (or has a section 73L group member that is) in relation to the ANLEC Project is outside the scope of this Ruling. If a Contributor in these circumstances wants to know whether section 73C applies to them they should apply for a private ruling.

Section 8-1

66. For the years of income ending 30 June 2008 to 30 June 2011 inclusive (or equivalent substituted accounting periods), the portion of the levy paid by a Contributor to the ACALET Program, which does not qualify for a deduction under section 73B, will be deductible under section 8-1 of the ITAA 1997.

Section 82KZMD

67. Where expenditure deductible under section 8-1 of the ITAA 1997 is for activities to be carried on not within the expenditure year, section 82KZMD applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

68. Note that this Ruling only applies to contributions used to fund the ANLEC Project undertaken by ANLEC in accordance with the Funding Agreement as at the date of the application requesting this Ruling.

Commissioner of Taxation
5 December 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.

Subsection 73B(14) – research and development expenditure (R&D expenditure)

69. Subsection 73B(14) allows a deduction if an eligible company incurs R&D expenditure (other than contracted expenditure) during a year of income if that company's aggregate R&D amount is greater than $20,000 (subject to any other relevant requirements in section 73B being satisfied).

70. In accordance with subsection 73B(14), the deduction an eligible company can claim is calculated by multiplying the expenditure incurred by 1.25 in each year of income.

71. A deduction will be available in a year of income under subsection 73B(14) if:

- an eligible company;
- with an aggregate R&D amount greater than $20,000;
- incurs 'research and development expenditure' (as defined in subsection 73B(1)) during a year of income; and
- the deduction is not prevented by other provisions of section 73B.

72. Given that there is no partnership between contributing companies, subsections 73B(3A) and 73B(3B) do not apply.

Eligible company

73. An eligible company means a body corporate incorporated under a law of the Commonwealth or a State or Territory (subsection 73B(1)).

74. The class of entities to which this Ruling applies comprises eligible companies within the meaning of subsection 73B(1). Therefore this requirement is satisfied for the class of entities to which this Ruling applies.

Aggregate research and development amount

75. To qualify for a deduction under subsection 73B(14), an eligible company must also have an aggregate R&D amount that exceeds $20,000. The term 'aggregate research and development amount' is defined in subsection 73B(1).

76. As the class of entities that this Ruling applies to comprise eligible companies with an aggregate R&D amount exceeding $20,000, this requirement is satisfied. Note that any company that does not have an aggregate R&D amount exceeding $20,000 will not be entitled to claim a deduction under subsection 73B(14).

Incurs R&D expenditure

77. Contributors pay levies to ACALET in accordance with the Contribution Deed. Contributors therefore incur expenditure that is paid to the ANLEC Project for the purposes of subsection 73B(14).

78. In accordance with subsection 73B(1), 'research and development expenditure' is defined as:

> 'in relation to an eligible company in relation to a year of income means expenditure (other than core technology expenditure, interest expenditure, feedstock expenditure, excluded plant expenditure or expenditure incurred in the acquisition or construction of a building or of an extension, alteration or improvement to a building) incurred by the company during the year of income, being:
>
> (a) contracted expenditure of the company;
>
> (b) salary expenditure of the company being expenditure incurred on or after 1 July 1985; or
>
> (c) other expenditure incurred on or after 1 July 1985 directly in respect of research and development activities carried on by or on behalf of the company on or after 1 July 1985;
>
> and includes any eligible feedstock expenditure that the company has in respect of related research and development activities.'

Excluded expenditure

79. Certain expenditure is excluded from the definition of R&D expenditure. It is not considered that contributions to the ACALET Program result in Contributors having any of the excluded expenditure types as listed in paragraph 77 of this Ruling, for the reasons below:

- the Contributor is not acquiring or acquiring the right to use any existing technology for the purposes of R&D activities;
- contributions are not interest or an amount in the nature of interest incurred in the financing of R&D activities;
- contributions are not incurred by the Contributors in acquiring or producing materials or goods to be the subject of processing or transformation by the company in R&D activities) ;

- contributors are not the holder of any section 73BA depreciating assets under section 40-40 of the ITAA 1997 as a result of their contributions to the ACALET Program and therefore the expenditure is not for the acquisition or construction, nor does it otherwise form part of the cost of a section 73BA depreciating asset; and
- contributors neither acquire, construct, alter, nor improve any building etc as a result of making contributions.

R&D expenditure

80. The expenditure in question is not paid to the Coal Research Trust Account, or to a registered research agency under section 39F of the IR&D Act 1986. Therefore, the expenditure is not contracted expenditure as defined in subsection 73B(1). Further, the expenditure is not for payments made to/for an officer or employee of the Contributors (for example, salary, superannuation, pay-roll tax or worker's compensation). Therefore, the expenditure is not salary expenditure as defined in subsection 73B(1).

81. The question then is whether the expenditure falls within paragraph (c) of the definition of R&D expenditure. The expenditure is incurred on or after 1 July 1985, so the issues to consider are:

- whether the expenditure is incurred directly in respect of research and development activities; and
- whether the activities are carried on by or on behalf of the Contributors.

82. Whether R&D activities are to be carried out 'on behalf of' Contributors as required by the definition of R&D expenditure in subsection 73B(1) and not on behalf of any other persons besides the Contributors, for the purposes of subsection 73B(9), is considered in paragraphs 89 to 112 of this Ruling. Note that the activities in question are not carried out by any of the Contributors.

Whether the expenditure is incurred directly in respect of R&D activities

83. The meaning of the phrase 'directly in respect of' has not yet been judicially considered in the context of subsection 73B(1). However, the meaning given to 'expenditure directly in producing a film', in *FC of T v. Faywin Investments Pty Ltd* (1990) FCR 461 (*Faywin*), of requiring a sufficiently close connection between the expenditure and the film production is thought to provide an appropriate guide to what will be required for expenditure to be 'directly in respect of' R&D activities. As in *Faywin*, just because the expenditure may have been incurred to an intermediary, will not of itself preclude the expenditure from being directly in respect of the R&D activities in question.

84. Factors to consider are the terms and conditions under which the expenditure might have been incurred, and how they might link the expenditure to the performance of the relevant R&D activities, the time elapsed between when the expenditure was incurred and when the R&D activities in question are carried out, whether the expenditure can be seen in a practical sense to give rise to those activities, and whether the expenditure can reasonably be expected to produce results from those activities on behalf of the company incurring that expenditure.

85. The terms of the Contribution Deed show that contributions will be applied exclusively in respect of R&D, demonstration projects and management and administration expenses relating to the above. The Funding Agreement specifies contributions can only be used for the purposes of the ANLEC Project. Some of the contributions will therefore be directed towards R&D activities listed in paragraphs 54 to 58 of this Ruling. Similar to other parties to the ANLEC Project, Contributors benefit from the results of the R&D activities, including receiving final reports and also have the same rights in relation to the use of project IP for internal purposes as other parties to the ANLEC Project. This shows there is a practical link between the expenditure, the activities and the results to be produced from the activities.

86. Therefore, this illustrates that there is a sufficiently close connection between the portion of contributions used to fund the carrying on of R&D activities of the ANLEC Project, such that this expenditure qualifies as being 'directly in respect of' 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.

87. This conclusion is not prevented by the fact that payments are made to an intermediary.

88. Note that the definition of R&D expenditure in subsection 73B(1) also requires that the relevant R&D activities are undertaken 'on behalf of' the company (in this case the 'company' refers to a Contributor). Expenditure will not be R&D expenditure unless this additional requirement is satisfied.

Is the deduction otherwise precluded under section 73B?

89. As mentioned in paragraph 70 of this Ruling, a deduction is only available under subsection 73B(14) if all other relevant requirements of section 73B are satisfied. Two subsections that must be considered in this respect are:

- subsection 73B(9); and
- subsection 73B(10).

Subsection 73B(9) – 'on behalf of any other person'

90. Subsection 73B(9) provides that a deduction is not allowable under section 73B (except subsection 73B(14C)) in respect of expenditure incurred by an eligible company for the purpose of carrying on R&D activities 'on behalf of any other person'. Expenditure of that kind is disregarded for the purposes of the application of section 73B (except subsections 73B(14C) and 73B(14D)) to the company. Note that subsections 73B(14C) and 73B(14D) refer to deductions that can be claimed for expenditure on foreign owned R&D. These provisions are not relevant to this Ruling, as the expenditure in question is not expenditure on foreign owned R&D as defined in subsection 73B(14D).

91. There is a link between subsection 73B(9) and the requirement set out in the definition of R&D expenditure in subsection 73B(1). Expenditure incurred by an eligible company will only qualify as 'research and development expenditure' as defined in subsection 73B(1) if the R&D activities are carried out 'by or on behalf of' the Contributor.

92. Therefore, Contributors paying levies to ACALET will only be able to claim a deduction under section 73B, if the expenditure is incurred directly in respect of R&D activities carried out on behalf of that Contributor, and not incurred for the purpose of carrying out those activities on behalf of any other person (subject to the other requirements in section 73B being satisfied).

Purpose

93. The purpose under consideration is that of the relevant expenditure, determined at the time of incurring the expenditure.

94. Contributors pay levies in accordance with the Contribution Deed. They are aware of its contents, including the activities to which it refers, at the time the expenditure is incurred. Therefore, the purpose of the expenditure of this nature is to fund those activities (including R&D).

'on behalf of'

95. A levy imposed on industry members as a means of raising funds to support R&D activities may qualify for the concession to the extent that the levy payments are expended on qualifying R&D activities carried out 'on behalf of' those industry members. For R&D activities to be carried out by or on behalf of a company that is an industry member, there must be a close and direct link between the company and the work undertaken.

96. However, in accordance with subsection 73B(9), an eligible company generally cannot claim a deduction at the concessional rate in respect of expenditure incurred for the purpose of carrying on R&D activities on behalf of any other person. It is not necessary that the company be acting as an agent of the other person; the question is whether, in all the circumstances, the R&D is to be carried out in substance on behalf of the other person. This will be a question of fact in each case.

97. There has been no judicial interpretation of the phrase 'on behalf of' as used in the section 73B. However, the phrase has been considered by the courts in relation to its use in other statutory contexts as outlined in Class Ruling CR 2009/45. We consider that those cases are also relevant for the purposes of this Ruling and the relevant principles are summarised below.

- A determination of whether a payment or act is 'conducted for the R&D entity' must be made objectively on the evidence provided.[1]
- The phrase 'conducted for the R&D entity' does not have strict legal meaning and can be used in a wider sense than the legal relation of principal and agent.[2]
- An examination needs to be made of whether a payment is made 'substantially in the interest of' the payer or another and the 'extent of the comparative benefit' it confers.[3]

98. The factors discussed in paragraph 98 of this Ruling are also considered relevant.

99. The requirements in provisions such as subsection 73B(1) and subsection 73B(9) (collectively referred to as the 'on own behalf requirement') effectively prevent double deductions being claimed in respect of the same R&D activities by restricting entitlement to the concessional deduction to the eligible company that:

- has control over the R&D project;
- effectively owns the project results; and
- bears the financial risk associated with the R&D project.

100. Arrangements which in substance abdicate either ownership or control could compel the conclusion that R&D activities were not being carried out on behalf of the company. In order to determine if R&D activities are undertaken on behalf of the Contributors paying levies to ACALET it is necessary to consider how the factors referred to at paragraph 98 of this Ruling apply to those companies.

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[1] *Cuthbertson and Richards Sawmills Pty Ltd v. Thomas* (1999) 93 FCR 141.
[2] *R v. Portus; Ex parte Federated Clerks Union of Australia* (1949) 79 CLR 428.
[3] *Federal Commissioner of Taxation v. Robinson* 92 ATC 4424; (1992) 23 ATR 364.

Control

101. It is considered that the Contributors, as a group, sufficiently control the R&D activities that they have contracted ACALET to provide. The Contribution Deed has set the parameters for the R&D to be undertaken and the underlying philosophies which ACALET is bound to follow. The Contributors have effective legal control, as they have the ability to compel ACALET to perform in accordance with the Contribution Deed. The manner in which the program is executed also supports the conclusion that the Contributors have sufficient control over the R&D activities.

Effective ownership

102. A company effectively owning results of the relevant R&D activities is another pointer to those activities being carried out on behalf of 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 the advantages of ownership.

103. 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.

104. Co-owners who can, as a practical matter, make use of their results in their individual activities often do not make any specific agreements about their rights as between themselves. For instance, members of industry associations may be effectively co-owners of the R&D results obtained on their behalf. Free individual use of those results is practical for them. Co-ownership of this kind is consistent with the R&D having been carried out on behalf of the individual co-owners, each of whom has a proper and effective separate interest in the results. Where each such co-owner makes a contribution, even if the contributions vary somewhat, those contributions would not usually be regarded as having been made for the purpose of carrying out R&D activities on behalf of the other co-owners.

105. Where co-owners must effectively share results or their use, the question will be whether their individual share in those results is commensurate with their contribution. This is determined by a comparison of the contributions of the co-owners to the R&D activities with their interest in or share of the results.

106. In addition, it is important to consider whether a Contributor's interest in the overall results is appropriate to its contribution to overall research in circumstances where the research builds on existing research belonging to another person. The same principles apply when considering circumstances where the substance of a proposed arrangement shows the researcher is the holder of its own research results and their interest in the results of the R&D activities reflects their contribution.

107. ACALET uses levies paid by Contributors to fund the ANLEC Project. Any IP generated as a result of the ANLEC Project will not be legally owned by the Contributors. However, we are more concerned with effective ownership of the results of the R&D projects and whether the benefits obtained by the Contributors are such that they have an interest in the results of the ANLEC Project that is commensurate with their contributions.

108. The Contribution Deed between ACALET and the Contributor promises '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 agreements'.

109. In order to determine whether the 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 that expenditure to the Contributors.

110. Taking into account ACALET's entitlement to:

- biannual reports;
- membership of (and role in) the PRC;
- oversee and review the formulation of the Annual Plan for the Project; and
- specify rights in relation to any Agreement Material generated by the Project.

111. It is considered that 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 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.

Financial risk

112. In accordance with the Contribution Deed, Contributors pay levies which are calculated at a rate of up to $0.20 per tonne of coal produced over the term of the agreement. Payments are required on a quarterly basis. The Contribution Deed makes it clear that these contributions become the property of ACALET. These contributions cannot be refunded to Contributors.

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

Subsection 73B(10) – registration

114. In accordance with subsection 73B(10), a deduction is not allowable under subsection 73B(14) unless the company is registered for the activities to which the expenditure relates under section 39J of the IR&D Act 1986.

115. The class of entities to which this Ruling applies comprises companies registered in relation to specific R&D activities in accordance with the requirements of subsection 73B(10). Therefore, this requirement is satisfied for the class of persons to which this Ruling applies.

Summary

116. Contributions incurred by Contributors to ACALET that are directly in respect of R&D activities carried out 'on behalf' of the Contributors will be deductible under subsection 73B(14). Subsection 73B(9) will not preclude the deduction under subsection 73B(14) from being allowable. However, the prepayment rules discussed in paragraphs 127 to 139 of this Ruling, may impact on the amount and timing of any deduction available.

Clawback

117. Section 73C applies where:

- an eligible company has incurred expenditure (*relevant expenditure*) on R&D activities that formed or form part of a particular project carried on by or on behalf of the company; and
- the company (or another person it is grouped with under section 73L at the time of receipt of entitlement) has received, or become entitled to receive, a recoupment of, or a grant in respect of, the whole or any part of the relevant expenditure by or from the Commonwealth, a State or a Territory, an STB (within the meaning of Division 1AB) or an authority constituted by or under a law of the Commonwealth, of a State or of a Territory.

118. Any R&D expenditure that is subject to clawback is not deductible at a rate of 125%. Instead the amount of the expenditure is only deductible at a rate of 100%.

119. The Commonwealth has agreed to provide funding to ANLEC for the Project. However, section 73C does not apply to any expenditure incurred by Contributors that are not recipients of that funding and are not grouped under section 73L with any recipients of that funding at the time of the receipt or entitlement of the funding.

120. Any receipt of the Commonwealth funding by a Contributor or their section 73L group member in relation to the ANLEC Project is outside the scope of this Ruling. If a Contributor in this position wants to know whether section 73C applies to them they should apply for a private ruling.

Section 8-1 – general deduction

Entitlement to a deduction for payments made under the Contribution Deed that do not qualify for a deduction under section 73B

121. To the extent that a payment made by a Contributor does not qualify for a deduction under section 73B, it may nevertheless be deductible under section 8-1 of the ITAA 1997. To be entitled to a deduction under section 8-1 of the ITAA 1997 a Contributor will need to satisfy subsection 8-1(1), and also not be precluded by any part of subsection 8-1(2) of the ITAA 1997.

122. Generally, this means that the payment will need to be:

- capable of being characterised as a 'working or operating expense' of the business of that Contributor; and
- necessarily incurred in carrying on the business of that Contributor.

Taxation Ruling TR 95/1[4]

123. Taxation Ruling TR 95/1 considers whether advertising costs associated with opposing legislation will be a deductible expense. TR 95/1 was issued as a result of the decision in *FC of T v. Rothmans of Pall Mall (Aust) Ltd* 92 ATC 4508; (1992) 23 ATR 620 (*Rothmans*).

124. The decision in *Rothmans* provides some assistance in determining a Contributor's entitlement to a deduction under the scheme set out in this Ruling. *Rothmans* concerned a claim for a deduction by a member of the Tobacco Institute of Australia ('the Institute'). That member claimed their contribution to the Institute as a deduction from their assessable income. At paragraph 10 of TR 95/1, the Commissioner notes that:

> The Court decided that the nature of the expenditure incurred by the company was, *in the present commercial environment, an ongoing part of the circumstances in which companies carry on business. Accordingly, it was incidental to the carrying on of its business and did not involve the acquisition of an enduring asset*. Lockhart J relied upon the decisions of the High Court in *FC of T v. Snowden & Willson Pty Ltd* (1958) 99 CLR 431 and of the Federal Court in

[4] Taxation Ruling TR 95/1 *Income tax: deductibility of advertising that opposes the passing of legislation*.

> *Magna Alloys and Research Pty Ltd v. FC of T* 80 ATC 4542; (1980) 11 ATR 276. His Honour found that the company was not seeking to maintain or preserve an existing capital asset by paying the levy to the Tobacco Institute. [emphasis added]

125. The principle established in *Rothmans* can be extended to include any portion of the levy payment (that does not qualify under section 73B), which can be properly characterised as being incidental to the Contributor's business.

126. Where a Contributor makes a payment to ACALET, which enables it to promote its involvement with the ANLEC Project, it will be appropriate to characterise a portion of that payment as being in the nature of a marketing expense. The contributions are regular payments that do not produce any enduring benefit or advantage to the Contributors, but rather are intended to assist them in marketing their product.

127. Accordingly, in these circumstances, the payment will be deductible under subsection 8-1(1) of the ITAA 1997, and will not be precluded by any part of subsection 8-1(2) of the ITAA 1997.

Prepayments

128. The timing of any deductions that are available under subsection 73B(14) and section 8-1 of the ITAA 1997 can be affected by the prepayment rules. Section 82KZMA 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, the taxpayer could deduct expenditure under section 73B, 73BA, 73BH, 73QA, 73QB or the former section 73Y or section 8-1 of the ITAA 1997; and
- the requirements in subsections (2), (3), (4) and (5) are met.

129. As discussed above, the requirements of subsection 73B(14) will be met for expenditure incurred directly in respect of R&D activities, and section 8-1 of the ITAA 1997 will be met for any remaining expenditure incurred by Contributors to ACALET under the Contribution Deed. Therefore it also needs to be considered whether the requirements of subsections 82KZMA(2), (3), (4) and (5) are also satisfied for the expenditure in question.

Whether subsections 82KZMA(2), (3), (4) and (5) are satisfied

130. We consider that subsections 82KZMA(2) to (5) are satisfied for the reasons outlined below:

- subsections 82KZMA(2) will be satisfied irrespective of whether 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) ;
- for reasons discussed in paragraph 125 of this Ruling, the expenditure is not capital in nature, and therefore is not excluded expenditure as required by subsection 82KZMA(4). Further, none of the other excluded expenditure categories apply to the contributions made by the Contributors; and
- in accordance with subsection 82KZMA(5), the expenditure is not a pre-RBT obligation.[7]

131. In accordance with 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 Contributors depends on the complex 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.

132. The substance of these agreements is that the expenditure will typically relate to activities to be carried out at some future time, on the basis that ANLEC requires funds in advance in order to see that the activities in question are begun.

133. 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 ANLEC 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.

134. 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 ANLEC'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

135. In accordance with subsection 82KZMD(2), for each year of income containing all or part of the eligible service period for the expenditure, the taxpayer may deduct the amount under subsection 73B(14) or section 8-1 of the ITAA 1997 determined using this formula:

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

136. 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.

137. Relevant to the task of determining the eligible service period are the Contribution Deed, Funding Agreement, and any other relevant agreements entered into for the purposes of the ANLEC Project. In addition, biannual reports, annual reports and annual budgets provided to ACALET for the purposes of the ANLEC Project will also be of assistance.

138. Identification of when the various activities are to commence and cease is best done by reference to the underlying planning and budgetary documentation that guides ANLEC's actions. Determination of these commencement and cessation times will necessarily, in the circumstances, be one of reasonable estimation, rather than something that occurs with absolute precision.

139. Analysis of the ANLEC 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 ANLEC Project's activities, 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.

140. 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.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/1; TR 2006/10; CR 2009/45; CR 2010/44; CR 2012/82

Subject references:

- on own behalf
- research and development expenditure

Legislative references:

- ITAA 1936 Div 1AB
- ITAA 1936 73B
- ITAA 1936 73B(1)
- ITAA 1936 73B(3A)
- ITAA 1936 73B(3B)
- ITAA 1936 73B(9)
- ITAA 1936 73B(10)
- ITAA 1936 73B(14)
- ITAA 1936 73B(14C)
- ITAA 1936 73B(14D)
- ITAA 1936 73C
- ITAA 1936 73L
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZMA
- 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 1936 82KZMD(2)
- ITAA 1997 8-1
- ITAA 1997 8-1(1)
- ITAA 1997 8-1(2)
- ITAA 1997 40-40
- ITAA 1997 328-110
- Industry Research and Development Act 1986 39F
- Industry Research and Development Act 1986 39J
- Industry Research and Development Act 1986 39L
- Industry Research and Development Act 1986 39S
- TAA 1953
- Copyright Act 1968

Case references:

- Federal Commissioner of Taxation v. Robinson 92 ATC 4424; (1992) 23 ATR 364
- Federal Commissioner of Taxation v. Rothmans of Pall Mall (Aust) Ltd (1992) 37 FCR 582; 92 ATC 4508; (1992) 23 ATR 620
- Federal Commissioner of Taxation v. Snowden & Willson Pty Ltd (1958) 99 CLR 431
- Federal Commissioner of Taxation v. Faywin Investments Pty Ltd (1990) 22 FCR 461; 90 ATC 4361; (1990) 21 ATR 256
- Magna Alloys and Research Pty Ltd v. Federal Commissioner of Taxation (1980) 33 ALR 213; 80 ATC 4542; (1980) 11 ATR 276
- R v. Portus; Ex parte Federated Clerks Union of Australia (1949) 79 CLR 428

ATO references
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