CR 2014/93 - Income tax: research and development: membership funding for the Australian Coal Association Research Program

Class Ruling

Income tax: research and development: membership funding for the Australian Coal Association Research 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 355-100 of the ITAA 1997
- section 355-205 of the ITAA 1997
- section 355-210 of the ITAA 1997
- section 82KZL of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 82KZMA of the ITAA 1936, and
- section 82KZMD of the ITAA 1936.

All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies comprises 'R&D entities', as defined by section 355-35 who are liable for levy contributions under the Australian Coal Association Research Program (ACARP) to Australian Coal Research Ltd (ACR), and who:

- are registered with Innovation Australia, in accordance with the requirements of subparagraph 355-205(1)(a)(i) for the relevant years of income
- have notional deductions identified by reference to paragraphs 355-100(1)(a)-(g) for the relevant years of income, and
- are not a small business entity as defined in section 328-110.

4. In this Ruling the term 'Contributor' is used to refer to those companies that are ultimately obliged to pay levy contributions to ACR under the ACARP. In the Deed of Agreement discussed below, those companies are either the 'mine owner(s)' or 'operator(s) of coal producing assets' or 'contributor(s)' where no separate 'mine owner(s)' are identified in the Deed of Agreement.

5. This Ruling **does not apply** to R&D entities that are not registered for the relevant years of income with Innovation Australia. The publication of this Ruling does not relieve companies making contributions to the ACARP of the obligation to make separate applications for registration of their activities under section 27A 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.

7. 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 17 to 52 of this Ruling.

8. The description of the scheme in this Ruling is a generic one, capable of applying to a number of specific projects funded, or to be funded, through the ACARP. However, the Commissioner does not provide any guarantee that any actual project does fall within this description. Contributors will need to confer with ACR to obtain this assurance.

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

10. This Ruling applies from 1July 2015 to 30 June 2020. The Ruling continues to apply after 30 June 2020 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).

Previous Rulings

11. Class Ruling CR 2005/9 was issued on 9 March 2005, regarding membership funding for the ACARP. Class Ruling CR 2005/9 applied to the income years ended 30 June 2006 to 30 June 2010.

12. Class Ruling CR 2009/45 was issued on 26 August 2009 and applied to income years ending 30 June 2011 to 30 June 2015. The Class Ruling concerned membership contributions made to ACARP in relation to the income tax laws enacted at the date of issue.

13. Following the issuing of the Class Ruling there was a significant legislative change in the *Tax Laws Amendment (Research and Development) Act 2011* (the Amendment Act) which received Royal Assent on 8 September 2011.

14. The Amendment Act inserted a new Division 355 into the ITAA 1997 and repealed sections 73B to 73Z of the ITAA 1936.

15. Due to the legislative change, Class Ruling CR 2009/45 ceased to have effect from and including the income year ending 30 June 2012.

16. Class Ruling 2012/82 was issued on 26 September 2012, regarding membership funding for the ACARP. CR 2012/82 applied to the income years ended 30 June 2012 to 30 June 2015.

Scheme

17. 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:

- the application for a Class Ruling and accompanying attachments dated 1 July 2014, and
- email to the ATO from the applicant and accompanying attachment dated 12 September 2014.

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

Memorandum of Understanding

18. The ACARP was formed in accordance with a Memorandum of Understanding (the original MOU) between the Australian Coal Association (ACA) and the Commonwealth Government.

19. The original MOU between the chairman of ACA and the then Minister for Primary Industries and Energy was first signed on 22 January 1992. The arrangement set out in the MOU has been extended on five occasions beyond its original expiration date of 30 June 1996. The current extension will conclude on 30 June 2015.[1]

20. The ACA's responsibility for the ACARP were transferred to the Minerals Council of Australia (MCA) as a result of a decision to wind-up the ACA and integrate its functions with the MCA. In 2014 the MCA and the Commonwealth Government entered into a new Memorandum of Understanding (MOU).

21. The new MOU commenced on 8 April 2014 and continues until 30 June 2015, with an optional extension to 30 June 2020 and further extensions from 30 June 2020 at five year intervals. The extensions are subject to the MCA confirming in writing to the Department of Industry that all Australian black coal producers are committed to continuing to pay a voluntary levy, capped at 5 cents per tonne of saleable black coal produced.[2]

22. By letter dated 24 February 2014, the Minister for Industry agreed to extend the MOU until 30 June 2020 subject to the MCA confirming by 31 March 2015 that all Australian black coal producers agree to pay the voluntary levy, continuing to 30 June 2020.

23. The purpose of the MOU is to provide for the continuation of the Australian coal industry research arrangement, ACARP, which replaced the operations of the Coal Research Trust Account. The arrangement is designed to provide for collective and integrated research on coal for the purpose of:

- providing strategic leadership to industry research and development (R&D) within the coal and its associated industries
- improving the management and application of coal research in Australia
- ensuring the more effective use of Australia's black coal resources
- increasing the economic, environmental, safety and social benefits of that research to the industry and wider community, and

[1] Memorandum of Understanding between Minister for Resources and Energy and Australian Coal Association, dated 29 October 2009.
[2] Memorandum of Understanding between the Commonwealth of Australia represented by the Department of Industry and Minerals Council of Australia, effective from 8 April 2014.

- promoting the competitiveness, sustainable use and management of Australia's coal resources.

24. The MOU explains that in the pursuit of these objectives the MCA undertakes to allocate research funds so raised, including interest earned, exclusively for the administration and execution of coal R&D activities.

Australian Coal Research Limited

25. ACA established a legal entity, Australian Coal Research Limited (ACR) to carry out all ACARP Management (including financial and statutory responsibilities) on its behalf. ACR will continue to carry out these responsibilities on the MCA's behalf pursuant to the terms of the MOU and the Performance Deed between MCA and ACR, dated 20 March 2014.

26. ACR's Constitution[3] describes its objects, many of which mirror those in the MOU.

27. The Board of ACR comprises senior industry personnel nominated by Contributors. In addition, ACR also has an executive director. The board of ACR has the ultimate authority for approval of all project commitments.

28. There is a Research Committee with overview of technical direction and five Technical Committees with specific technical focus that undertake detailed considerations of the program, including research objective priorities, project selection and ongoing monitoring. All committees are comprised of industry personnel nominated by the Contributors.

29. ACR is an income tax exempt entity.

30. ACR is currently registered as a research service provider (levy collecting) under section 29A of the IR&D Act 1986 in relation to the research field categories of R&D activities that are carried out, and will have its registration extended for the years relevant to this Ruling.

31. ACR is not an 'associate' of any Contributors as defined in section 318 of the ITAA 1936.

Deed of Agreement between ACR and each operator of coal producing assets (Deed of Agreement)

32. Each affected coal producer (referred to in the Deed of Agreement as an 'operator of coal producing assets') enters into a Deed of Agreement with ACR under which they are liable to make Contributions (contributions or levies). Agency clauses are present in the agreement, which indicate that in some circumstances the operator of coal producing assets is entering into the Deed of Agreement on behalf of each of the mine owners.

[3] Constitution of Australian Coal Research Limited, dated September 2009.

33. Contributions are calculated at the rate of $0.05 per tonne of coal produced by the operator during the term of the agreement, on a monthly basis. All Contributions paid to ACR become property of ACR.

34. The Deed of Agreement defines 'research and development' as follows:

> **Research and Development** means scientific, technical or economic research in connection with the exploration, mining, beneficiation and use of coal or products derived from coal, including the demonstration and development thereof, and includes:
>
> (a) the training of persons for the purpose of any such research and development;
>
> (b) the publication of reports, periodicals, books and papers in connection with such research and development;
>
> (c) the dissemination of information and advice in connection with scientific, technical or economic matters related to exploration, mining, beneficiation and use of coal or products derived from coal;
>
> (d) any matters incidental or relating to a matter referred to in this definition;
>
> (e) any matters incidental or relating to the obligations of ACR under this deed including costs incurred in collection of Contributions.

35. In the Deed of Agreement, ACR promises that contributions will be applied exclusively in respect of 'research and development'. It is noted that the definition of 'research and development' in the Deed of Agreement between ACR and the operator of coal producing assets is different to the definition of 'R&D activities' in section 355-20. However, the applicant advises that levies are directed only to those activities meeting the requirements of the definition of 'research and development' under the Deed. Activities outside of this definition are supported by non-levy funds.

36. ACR also 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' entered into by ACR in relation to the ACARP program.

37. Each party has the right to terminate the Deed of Agreement if, amongst other things, the other party commits a breach of their obligations under the deed and the breach cannot be or is not rectified.

38. The Deed of Agreement 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. According to the Deed of Agreement, Contributors also have the right to access final research reports upon request.

39. All black coal producers in Australia are expected to enter into the Deed of Agreement and thus become liable to make contributions to ACR for the period 1 July 2015 to 30 June 2020.

ACARP's funding and operations

40. Levies paid to ACR by Contributors that are directed towards R&D activities, as defined in the Deed of Agreement, constitute 'expenditure incurred' for the purposes of section 355-205.

41. The R&D activities which ACR arranges to be conducted for the Contributors are, and will be, consistent with its Constitution and the Memorandum of Agreement. Specific R&D activities will vary from project to project. Whether or not these specific activities are covered by Division 355 and section 27 of the IR&D Act 1986, will depend on the terms of sections 355-20, 355-25 and 355-30 (being the definitions respectively, of R&D activities, core R&D activities and supporting R&D activities) being met. (see further paragraph 55 of this Ruling).

42. All levy contributions are accepted as being used for R&D activities, as defined in the agreement. The levies fund projects carried out under 'Fundamental', 'Applied' and 'Commissioned Study' R&D agreements to which ACR is a party. Other activities are funded by interest earned on funds held for future commitments and royalties.

43. It is uncommon that any projects are completely funded under the ACARP. These projects are carried out on a collaborative basis with cash and in kind contributions made by other parties (including researchers).

44. Benefits received by Contributors and parties to these agreements from R&D projects including their interest in the results of the projects concerned, are commensurate with the contributions made.

45. Previous research has shown that the ACARP delivers significant net benefits to the coal industry. While ACR has obtained some commercialisation proceeds, this has been negligible, and is not expected to become a major benefit.

46. ACARP provides outcomes with general solutions to all aspects of concern to the Australian black coal industry as specified in the MOU, being the agreed purpose of the research program. It is a condition of the ACARP funding that the outcomes of every project must be available for use by Contributors. Contributors will individually decide whether they implement the outcomes of each project based on a wide range of commercial and other factors, given that not all projects funded by the ACARP have the same degree of immediate relevance to every Contributor and each mine is unique in itself.

Research and Development Agreements – Fundamental, Applied and Commissioned Study

47. ACR enters into agreements by which it engages researchers to carry out R&D activities, including

- Fundamental
- Applied
- Commissioned Study.

48. ACR also enters into other agreements (whether or not in collaboration or cooperation with others), which result in the undertaking of R&D.

49. ACR produces an ACARP Annual Report and a People and Projects Report which document the specific research projects funded by the ACARP levy during the year, the people involved in those projects and provide statistical and financial information.

50. Between 01 July 2010 and the end of June 2014, the ACARP commenced 216 projects under the above mentioned agreement types. Of these projects, 186 were undertaken under 'Fundamental' Research and Development Agreements, 18 under 'Applied' Research and Development Agreements, 5 under 'Commissioned Study' Research and Development Agreements and 7 were not agreed to under formal agreements, but rather an exchange of letters or some other approach. There is no evidence to suggest that these proportions will materially change in the future.

51. Common to all three formal agreements are the following conditions:

- all funding is to be used by the researcher for the sole purpose of performing its obligations under the funding and project agreement and must not be used for any other purpose
- a critical objective of the project is to make the results and outcomes of the research readily available to ACR on behalf of the Australian coal industry
- the researcher must submit a final report to ACR (describing all work done in connection with the project)
- ACR may publish the final report in any form that it considers desirable, and
- ACR and coal industry representatives will meet with the researcher to monitor the progress of the project and to consider amendments to the conduct of the project or the project objectives.

52. Typically these agreements are entered into for the purpose of generating knowledge benefits for Contributors, and this is the dominant benefit arising out of these agreements.

Ruling

Subdivision 355-C – Entitlement to a tax offset

53. For the years of income ending 30 June 2016 to 30 June 2020 inclusive (or equivalent substituted accounting periods), to the extent that a Contributor pays levies in an income year that:

- are for R&D activities as defined in section 355-20, and
- represent expenditure as defined by reference to section 355-205

they will be entitled to a tax offset calculated in accordance with section 355-100. Further, subsection 355-210(2) will not preclude a notional deduction arising under section 355-205.[4]

54. A notional deduction is not allowable under section 355-205 to a Contributor:

- for any part of the contributions incurred on activities that are not R&D activities, as defined in section 355-20, or
- for any part of the contributions incurred on R&D activities for which the Contributor is not registered under section 27A of the IR&D Act 1986 for each of the income years in question.

55. The Commissioner acknowledges that any opinion formed about the R&D activities referred to in this Ruling can be overridden by Innovation Australia.[5] Therefore, the Commissioner does not express an opinion about these activities and whether they are R&D activities as defined in section 355-20. This Ruling is made on the presumption (unless told otherwise by Innovation Australia) that the activities are R&D activities as defined under section 355-20.

Section 82KZMD and section 355-205

56. Where expenditure is notionally deductible under section 355-205, and the R&D activities to which the expenditure relates are not carried out in the current income year, section 82KZMD of the ITAA 1936 applies, such that the timing and amount of the deduction is allocated over the relevant eligible service period.

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[4] Subdivision 355-F may prevent a notional deduction arising under section 355-205. As discussed in paragraphs 75 to 79, this Ruling does not consider the application of Subdivision 355-F to the scheme described in paragraphs 17 to 52 of this Ruling.
[5] Subdivision 355-W.

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.

Meaning of R&D activities and other terms

57. R&D activities are defined in section 355-20. This Ruling applies only to those Contributors who are correctly registered with Innovation Australia, so that the activities being undertaken by ACR are taken to be R&D activities undertaken by the Contributors.

58. A Contributor cannot rely on this Ruling if Innovation Australia determines that:

- a Contributor is not eligible for registration in relation to the activities that ACR conducts in relation to the ACARP project, or
- the activities of the ACARP project do not constitute core R&D activities (within the meaning of section 355-25), or supporting R&D activities (within the meaning of section 355-30).

R&D Entities

59. R&D entities are defined in section 355-35 as:

(1) Each of the following is an ***R&D entity***:

(a) a body corporate incorporated under an *Australian law;

(b) a body corporate incorporated under a *foreign law that is an Australian resident.

(2) A body corporate incorporated under a *foreign law that:

(a) is a resident of a foreign country for the purposes of an agreement in force between that country and Australia that:

(i) is a double tax agreement (as defined in Part X of the *Income Tax Assessment Act 1936*); and

(ii) includes a definition of ***permanent establishment***; and

(b) carries on business in Australia through a permanent establishment (within the meaning of that definition) of the body corporate in Australia;

is an ***R&D entity*** to the extent that it carries on business through that permanent establishment.

(3) However, an *exempt entity cannot be an ***R&D entity***.

60. The class of persons to which this Ruling applies (Contributors) are R&D entities within the meaning of section 355-35. Therefore this requirement is satisfied for the class of persons to which this Ruling applies.

Entitlement to R&D tax offset

61. For the purposes of this Ruling, when calculating a Contributor's entitlement to an R&D tax offset it is necessary to first ascertain that they have notional deductions (for the purposes of Subdivision 355-C) for the year of income.

62. Where an R&D entity is entitled to deduct an amount under:

- section 355-205 (R&D expenditure)
- section 355-305 (decline in value of R&D assets)
- section 355-315 (balancing adjustment for R&D assets)
- section 355-480 (earlier year associate R&D expenditure)
- section 355-520 (decline in value of R&D partnership assets)
- section 355-525 (balancing adjustment for R&D partnership assets), or
- section 355-580 (CRC contributions);

then that amount is used in calculating the R&D entity's entitlement to a tax offset, which is determined by reference to the tables contained in section 355-100.

When notional deductions for R&D expenditure arise

63. Contributors pay contributions to ACR in accordance with the Deed of Agreement. Therefore, they incur expenditure when these payments are made. To the extent that the payments are 'incurred on one or more R&D activities', they will be expenditure within the meaning of section 355-205 and as such they will constitute a notional deduction to the R&D entity (Contributor) subject to the application of the prepayment rules (discussed below).

64. A tax offset will be available in a year of income under Subdivision 355-C to the extent that an R&D entity:

- incurs expenditure *on* one or more R&D activities (within the meaning of section 355-205) in the year of income
- is registered under section 27A of the IR&D Act 1986 for the year of income

- has notional deductions of at least $20,000 for that year of income (unless incurred to a registered research service provider), and
- is entitled to those notional deductions, and is not precluded by any other provision of Division 355.

Whether the contributions are incurred 'on one or more *R&D activities'

65. Paragraph 355-205(1)(a) says that in order to deduct expenditure for an income year the expenditure needs to have been 'incurred on one or more *R&D activities'. The nature of the connection between the expenditure and the R&D activities expressed by the word 'on' in this context is governed by its place in the overall scheme of Division 355.

66. In Division 355, section 355-5 provides that the object of the Division concerns encouraging the conduct of particular R&D activities. Paragraph 355-205(1)(b) envisages that an R&D entity might incur expenditure within paragraph 355-205(1)(a), that is, incurring that expenditure 'on' an R&D activity, by incurring an amount to an 'associate' of theirs. That associate might be the entity which conducts the R&D activity, or it might, in turn, pay its employees, or an agent, or an independent contractor, to conduct this activity. The requirement that the expenditure be linked to the conduct of particular R&D activities is also found in subsection 355-210(1), concerning whether the expenditure coming within paragraph 355-205(1)(a) has also been incurred on activities which have been 'conducted for' the R&D entity (see, paragraph 355-210(1)(a)).

67. Also in Division 355, section 355-110 provides for the spreading of an R&D entity's deductions under section 355-205 or section 355-480, where the prepaid expenditure rules in Subdivision H of Division 3 of Part III of the ITAA 1936 apply. Section 355-110 thus contemplates that there may be expenditure which comes within paragraph 355-205(1)(a), where there is a lapse in time between when that expenditure is incurred on particular R&D activities, and when those activities begin to be conducted.

68. The fact that the expenditure in question might be incurred to an intermediary, or that there might be a gap in time between the expenditure being incurred and when the R&D activities begin, therefore will not in themselves, mean that the expenditure fails the requirement of needing to have been 'incurred on one or more R&D activities'. On the other hand, having regard to the object of Division 355, expenditure that is 'on' an activity which is not an R&D activity, where that expenditure is not integral to the conduct of any R&D activity, cannot be said to be sufficiently connected to the conduct of any R&D activity in a way which would bring it within paragraph 355-205(1)(a).

69. Factors to consider in determining whether this sufficient connection exists include:

- the terms and conditions of any contract under which the expenditure in question has been incurred
- how those terms and conditions relate to the conduct of any R&D activities
- how many intermediaries there might be between the R&D entity and this conduct
- any lapse in time between when the expenditure is incurred and when the R&D activities begin to be conducted, and
- whether the expenditure can reasonably be expected to produce results 'for' the R&D entity incurring it, from the R&D activities the expenditure is said to have been incurred on.

70. The information provided by the applicant demonstrates that the amounts identified as relating to R&D activities for the purposes of section 355-20, are appropriately recognised in the reports prepared by ACARP for its Contributors. This enables a Contributor to correctly ascertain the amount of their levy contribution which has been expended on particular R&D activities identified as part of the relevant projects. Therefore, the first requirement is satisfied.

Registration under section 27A of the IR&D Act 1986

71. In accordance with subparagraph 355-205(1)(a)(i), an R&D entity's entitlement to a notional deduction in an income year, will only arise if (amongst other requirements) it is registered (for the activities to which the expenditure relates) under section 27A of the IR&D Act 1986.

72. The class of entities to which this Ruling applies comprise companies registered in relation to specific R&D activities in accordance with the requirements of subparagraph 355-205(1)(a)(i). Therefore, this requirement is satisfied for the class of entities to which this Ruling applies.

Notional deductions of at least $20,000

73. Ordinarily, to be eligible for an R&D tax offset, an R&D entity must have total notional deductions of at least $20,000 in the year of income. Where the expenditure is incurred to a registered research service provider, it is not subject to the $20,000 threshold requirement (subsection 355-100(2) Item 1).

74. As the class of entities to which this Ruling applies are R&D entities that have incurred expenditure to a registered research service provider,[6] the $20,000 notional deduction threshold requirement need not be met.

Preclusion by other provisions

75. Subsection 355-205(2) provides that a notional deduction arising under subsection 355-205(1) will be subject to the effect of:

- section 355-225 (excluded expenditure)
- Subdivision 355-F (integrity rules), and
- subsection 355-580(3) (CRC contributions).

Excluded Expenditure

76. Section 355-225 excludes certain types of expenditure from giving rise to a notional deduction under section 355-205, and subsequent inclusion in the calculation of any entitlement to a tax offset under section 355-100. The contributions to the ACARP do not result in Contributors having any of these excluded expenditure types in section 355-225, for the following reasons:

- Contributors neither acquire, nor construct a building or part of a building; or an extension, alteration or improvement to a building as a result of making contributions
- Contributors are not the holder of any Division 40 depreciating assets under section 40-40 as a result of their contributions to the ACARP, and therefore the expenditure is not for the acquisition or construction, nor does it otherwise form part of the cost of such depreciating assets
- contributions are not interest or an amount in the nature of interest incurred in the financing of R&D activities, and
- Contributors are not acquiring, or acquiring the right to use, any existing technology wholly or partly for the purposes of R&D activities.

Integrity rules

77. Subdivision 355-F sets out various rules which are intended to preserve the integrity and operation of the R&D tax incentive. Paragraph 3.155 of the Explanatory Memorandum to the Tax Laws Amendment (Research and Development) Bill 2010 (the EM) explains that Subdivision 355-F corresponds to the integrity provisions in former sections 73B and 73CA of the ITAA 1936.

[6] Registered under section 29A IR&D Act 1986.

78. This Ruling does not consider whether any of the integrity rules identified in Subdivision 355-F operate in such a way as to either prevent (or alter) a notional deduction that would otherwise arise under subsection 355-205(1).

79. A Contributor who wants to ensure that Subdivision 355-F does not apply to their circumstances should request a private ruling.

CRC contributions

80. Given that contributions are not being paid to any entity that is part of the Commonwealth government's CRC program, Subdivision 355-K does not apply to this Ruling.

R&D partnerships

81. Given that there is no partnership between Contributors, Subdivision 355-J does not apply to this Ruling.

Conditions for R&D activities

82. A Contributor's entitlement to a notional deduction under subsection 355-205(1) is subject to section 355-210 being satisfied. Section 355-210 provides specific conditions that must be satisfied before an activity will be regarded as an R&D activity to which subsection 355-205 applies. For the purposes of this Ruling those conditions are:

- that the R&D activities that give rise to the expenditure are being conducted 'for' the R&D entity (paragraph 355-210(1)(a)); and
- that the R&D activities are not being conducted, to a significant extent, for one or more other entities not covered by any paragraph of subsection 355-210(1).

83. Whether R&D activities are conducted 'for' a Contributor as required by paragraph 355-210(1)(a), and not 'to a significant extent' for any other persons besides the Contributors, as provided by subsection 355-210(2) is considered in the following paragraphs of this Ruling. Note that the activities in question are not carried out by any of the Contributors.

R&D activities conducted 'for' the R&D entity and not 'to a significant extent' for other entities

84. Entitlement to a notional deduction under section 355-205 for the payment of levies to ACR will only arise if that expenditure is incurred on R&D activities, and those R&D activities are conducted 'for' the R&D entity. Further, the R&D activities which give rise to that notional deduction under section 355-205 must not be 'conducted, to a significant extent' for any other entity which does not satisfy the qualifying condition in paragraph 355-210(1)(a).[7]

85. In explaining when expenditure on R&D will give rise to a notional deduction, the EM explains (at paragraphs 3.52 – 3.55):

> Generally, an R&D entity is only entitled to a tax deduction in relation to R&D activities conducted for the entity (whether by the R&D entity for itself or by another entity for it). Also, an entity cannot deduct its expenditure on R&D activities if it conducts those activities to a significant extent for another entity.
>
> This retains a key rule from the existing law commonly known as the 'on own behalf' rule. This rule is intended to limit eligibility for a notional R&D deduction to where an R&D entity is the major benefactor from the expenditure it incurs on the R&D activities. In certain situations, the rule also prevents duplication of claims by different R&D entities.
>
> Determining the major benefactor of expenditure on R&D activities involves examining the extent to which R&D activities are carried out for the R&D entity compared to the extent to which they are carried out for any other entity. This is tested by weighing up three key criteria, namely who:
>
> - 'effectively owns' the know-how, intellectual property or other similar results arising from the R&D entity's expenditure on the R&D activities;
> - has appropriate control over the conduct of the R&D activities; and
> - bears the financial burden of carrying out the R&D activities.
>
> In short, the question of whether an R&D activity is conducted for an R&D entity is a question of fact, determined by whether the activity is conducted in substance to provide the majority of knowledge benefits resulting from the activity, such as access to intellectual property, to this entity.
>
> Whether an R&D entity has effective ownership involves reviewing all the circumstances surrounding the conduct of the relevant activities and the ownership and control of, and/or ability to utilise, the intellectual property or similar results obtained from the expenditure on the R&D activities.

[7] Paragraphs 355-210(1)(b)-(e) consider various circumstances where the R&D activities are being conducted for entities under other specific qualifying conditions. This Ruling only applies to R&D activities which satisfy the condition specified in paragraph 355-210(1)(a).

86. These three key criteria apply to two of the conditions in section 355-210. The first condition concerns whether, in a positive sense, the R&D activities in question have been conducted 'for' the R&D entity (paragraph 355-210(1)(a)). The second concerns whether, in a negative sense, those R&D activities have been conducted 'to a significant extent', 'for one or more other entities not covered by any paragraph of subsection (1)' (subsection 355-210(2)). Applying these key criteria to a particular case requires weighing them up against the relevant facts and circumstances of that case.

Effective ownership

87. A company effectively owning results of the relevant R&D activities is the first identifying criterion in determining whether the R&D activities are being carried out for that company. However, it is recognised that this does not necessarily require that the company must be the proprietor of a piece of intellectual property (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 advantages of ownership.

88. 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.

89. ACR uses levies paid by Contributors to fund the R&D activities of the projects which are undertaken in accordance with the relevant R&D agreements. Any IP generated as a result of the relevant R&D activities will not be legally owned by the Contributors. In addition to having an interest in the relevant R&D activities, Contributors must have effective ownership of the overall results of the relevant project, such that they have an interest in the overall results of the relevant project which is commensurate with their contributions.

90. The Deed of Agreement between ACR and the operator of coal producing assets (on behalf of the mine owner) warrants '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'.

91. In order to determine whether 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 the expenditure to the Contributors.

92. An examination of 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 arrangement 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.

93. The fact that ACR may receive minimal commercialisation proceeds does not alter this conclusion.

Control

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

Financial Risk

95. The final identifying criterion is the degree of financial risk that Contributors are assuming when the R&D activities are undertaken. In accordance with the Deed of Agreement, Contributors pay contributions which are calculated at a rate of up to $0.05 per tonne of coal produced (sold) over the term of the agreement. Payments are required on a monthly basis. The Deed of Agreement makes it clear that these contributions become the property of ACR. These contributions cannot be refunded to Contributors.

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

Summary

97. The terms of the Deed of Agreement show that contributions to ACR will be applied exclusively in respect of R&D. The funding and project agreements specify that contributions can only be used for the purposes of the relevant project.

98. Contributors benefit from the results of the R&D activities, including receiving access to final reports. Contributors also have rights to use the results of the R&D activities associated with each project directly in connection with a business that they carry on. Thus there is a practical link between the expenditure and the activities, and the results to be produced from the activities.

99. This illustrates that there is a sufficiently close connection between the contributions used to fund the carrying on of R&D activities for the ACARP, such that this expenditure qualifies as being ‘for’ the activities identified as R&D activities. As discussed in paragraph 68 of this Ruling, the fact that payments are made to an intermediary does not preclude those payments from being on particular R&D activities.

100. An examination of the benefits that the 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.

101. Contributions incurred by Contributors to ACR, constitute expenditure on conducting R&D activities 'for' them, under section 355-205. Subsection 355-210(2) will not preclude any entitlement to a notional deduction on the basis that the R&D activity is being conducted to a significant extent for another entity, which itself does not satisfy section 355-210.

Prepayment

102. The timing of any entitlement to a tax offset available under section 355-100 can be affected by the prepayment rules. Section 82KZMA of the ITAA 1936 sets the amount and timing of deductions for expenditure that a taxpayer incurs in a year of income (the expenditure year), if:

- apart from section 82KZMD of the ITAA 1936, a deduction under section 8-1, or section 355-205 (R&D expenditure) or section 355-480 (earlier year associate R&D expenditure), in respect of the expenditure, would be allowable to the taxpayer; and
- the requirements in subsections 82KZMA(2) to (5) of the ITAA 1936 are met.

103. As discussed above, the requirements of section 355-205 (R&D expenditure) will be met for expenditure incurred on R&D activities incurred by Contributors to ACR under the Deed of Agreement. The requirements of subsections 82KZMA(2) to (5) of the ITAA 1936 must also be met.

Whether subsections 82KZMA(2) to (5) are satisfied

104. Subsections 82KZMA(2) to (5) of the ITAA 1936 are satisfied for the reasons outlined below:

- subsection 82KZMA(2) will be satisfied irrespective of whether the Contributors are carrying on a business or not;[8]
- paragraph 82KZMA(3)(a) 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);

[8] Paragraph 82KZMA(2)(a) requires that the taxpayer must either be carrying on a business, or be a taxpayer that is not an individual and does not carry on a business. Subsection 82KZL(3) states that the Subdivision has effect as if conducting R&D activities were carrying on a business. Further, taxpayers to whom paragraph 82KZMA(2)(b) (concerning small business entities) apply are outside the class of entities covered by this Ruling.

- the expenditure is not capital in nature, and therefore is not excluded expenditure[9] 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.[10]

105. Under 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 the Contributors depends on the 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.

106. The substance of these agreements however, is that the expenditure will typically relate to activities to be carried out at some future time, on the basis that ACR requires funds in advance in order to see that the activities which are the subject of the relevant project are begun.

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[9] Excluded expenditure, as defined in subsection 82KZL(1) to mean:
an amount of expenditure:
(a) less than $1,000; or
(b) required to be incurred by a law, or by an order of a court, of the Commonwealth, a State or a Territory; or
(c) under a contract of services; or
(d) to the extent that it is of a capital nature and cannot be deducted under:
(i) section 355-205 (R&D expenditure); or
(ii) section 355-480 (earlier year associate R&D expenditure);
of the *Income Tax Assessment Act 1997*; or
(da) to the extent that it is of a private or domestic nature; or
(e) that has been or is incurred after 21 September 1999 by a general insurance company in connection with the issue of a general insurance policy and was related or relates to the gross premiums derived by the company in respect of the policy; or
(f) that has been or is incurred after 21 September 1999 by a general insurance company in payment of reinsurance premiums in respect of the reinsurance of risks covered by general insurance policies, other than reinsurance premiums that were or are paid in respect of a particular class of insurance business where, under the contract of reinsurance, the reinsurer agrees, in respect of a loss incurred by the company that is covered by the relevant policy, to pay only some or all of the excess over an agreed amount.

[10] Pre-RBT obligation means a contractual obligation that:
(a) exists under an agreement at or before 11.45 am (by legal time in the Australian Capital Territory) on 21 September 1999; and
(b) requires the payment of an amount for the doing of a thing under the agreement; and
(c) requires the payment to be made before the doing of the thing; and
(d) cannot be escaped by unilateral action by the party bound by the obligation to make the payment.

107. Therefore, in respect of expenditure incurred over any one year, it will generally not be possible to conclude that it has all been incurred in return for doing things (the R&D 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 ACARP 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.

108. 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 the relevant project and ACR'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

109. Subsection 82KZMD(2) of the ITAA 1936, provides that for each year of income containing all or part of the eligible service period for the expenditure, the taxpayer may deduct the amount under section 8-1, or notionally deduct the amount under section 355-205 by applying this formula:

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

110. Under subsection 82KZL(1), 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 day – 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.

111. Relevant to the task of determining the eligible service period are the Deed of Agreement, the funding and project agreements, and any other relevant agreements entered into for the purposes of the relevant projects. In addition, quarterly reports, annual reports and annual budgets provided to ACR for the purposes of the relevant project will also be of assistance.

112. There is an inherent or expected degree of imprecision when applying the calculation required under section 82KZMD. As discussed in paragraph 108 of this Ruling, with reference to the ACR's underlying planning and budgetary documentation which guide its actions, it should be possible to calculate the amount identified in section 82KZMD with reasonable estimation.

113. Analysis of the relevant project's 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 activities of the ACARP project, 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.

114. 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 (refer to the definition of 'eligible service period' in subsection 83KZL(1) of the ITAA 1936).

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2005/9;
CR 2009/45; CR 2012/82

Subject references:

- on own behalf
- research and development tax offsets

Legislative references:

- ITAA 1936 73B
- ITAA 1936 73CA
- ITAA 1936 82KZL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMA(2)
- ITAA 1936 82KZMA(3)(a)
- ITAA 1936 82KZMA(3)(b)
- ITAA 1936 82KZMA(3)(c)
- ITAA 1936 82KZMA(4)
- ITAA 1936 82KZMA(5)
- ITAA 1936 82KZMD
- ITAA 1936 318
- ITAA 1997 Div 40
- ITAA 1997 40-40
- ITAA 1997 328-110
- ITAA 1997 Div 355
- ITAA 1997 355-5
- ITAA 1997 355-20
- ITAA 1997 355-25
- ITAA 1997 355-30
- ITAA 1997 355-35
- ITAA 1997 Subdiv 355-C
- ITAA 1997 355-100
- ITAA 1997 355-100(1)(a)
- ITAA 1997 355-100(1)(b)
- ITAA 1997 355-100(1)(c)
- ITAA 1997 355-100(1)(d)
- ITAA 1997 355-100(1)(e)
- ITAA 1997 355-100(1)(f)
- ITAA 1997 355-100(1)(g)
- ITAA 1997 355-100(2)
- ITAA 1997 355-110
- ITAA 1997 Subdiv 355-D
- ITAA 1997 355-205
- ITAA 1997 355-205(1)
- ITAA 1997 355-205(1)(a)(i)
- ITAA 1997 355-205(2)
- ITAA 1997 355-210
- ITAA 1997 355-210(1)
- ITAA 1997 355-210(1)(a)
- ITAA 1997 355-210(2)
- ITAA 1997 355-225
- ITAA 1997 355-305
- ITAA 1997 355-315
- ITAA 1997 Subdiv 355-F
- ITAA 1997 355-480
- ITAA 1997 Subdiv 355-J
- ITAA 1997 355-520
- ITAA 1997 355-525
- ITAA 1997 Subdiv 355-K
- ITAA 1997 355-580
- ITAA 1997 Subdiv 355-W
- TAA 1953
- Industry Research and Development Act 1986 27A
- Industry Research and Development Act 1986 29A

Other references:

- Explanatory Memorandum to the Tax Laws Amendment (Research and Development) Bill 2010

ATO references

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