


Decision impact statement

GQHC and Commissioner of Taxation

AAT citation:	[2024] AATA 409
Venue:	Administrative Appeals Tribunal
Venue reference no:	2020/0826
AAT member name:	Senior Member Grigg
Decision date:	16 February 2024
Appeals on foot:	No
Decision outcome:	Favourable to the Commissioner

Impacted advice

 The ATO is reviewing the impact of this decision on related advice and guidance products.

Summary

This Decision impact statement outlines the ATO's response to this case, which was concerned with whether:

- the Commissioner has the power to assess or make decisions as to whether an R&D entity's registered activities are eligible 'R&D activities' as defined in Division 355 of the *Income Tax Assessment Act 1997* in circumstances where no findings about an R&D entity's registration that bind the Commissioner were made (Finding) by Innovation and Science Australia (the Board) (the jurisdictional issue)
- the Applicant's registered activities in the relevant year were research and development (R&D) activities, and if so, were the activities in fact conducted in the relevant income year (the eligibility issue), and
- expenditure incurred by the Applicant in acquiring or producing both 'day old' chickens and poultry feed were feedstock input expenditure which requires a feedstock adjustment (the feedstock adjustment issue).

All decision paragraph references in this Decision impact statement are to the decision of *GQHC and Commissioner of Taxation* [2024] AATA 409, unless otherwise indicated.

All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1997* (ITAA 1997), unless otherwise indicated.

Brief summary of facts

The Applicant is a company that conducted poultry farming operations. For several income years, including the 2013 year, the Applicant had self-assessed and

registered with the Board multiple activities for incubation and hatchery processes, water quality, shed cleaning, and broiler improvement. The Board did not make any Findings under the relevant sections of the *Industry Research and Development Act 1986* (the IR&D Act) as to whether these activities were 'core R&D activities' or 'supporting R&D activities'.

The Applicant claimed an R&D tax offset in its 2013 tax return for notional R&D deductions which included expenditure it incurred to acquire 'day old' chickens and poultry feed that were purportedly incurred on 'R&D activities' as defined. The Applicant's assessable income included a feedstock adjustment with respect to that expenditure.

The Applicant subsequently objected to its 2013 notice of assessment on the basis that they had included in their assessable income an incorrect feedstock adjustment. The Commissioner disallowed the Applicant's objection.

Issues decided by the Tribunal

The Applicant needed to succeed on the feedstock adjustment issue, and on either of the jurisdictional or eligibility issues. The Applicant was unsuccessful on each issue.

Jurisdiction to decide eligibility of registered activities

In circumstances where a Board makes a Finding under any of sections 27B, 27J and 28E of the IR&D Act in relation to an R&D entity's registered activities, the Commissioner is bound by that Finding pursuant to section 355-705, provided the Finding is made within 4 years after the end of relevant income year.

The Tribunal referred to the comments made by Thawley J in the Full Federal Court decision of *Commissioner of Taxation v Auctus Resources Pty Ltd* [2021] FCAFC 39 before holding at [157], consistent with *Auctus*, that:

- (a) "findings" made by the Board are clearly a pre-condition to the Commissioner being bound. There is no statutory impediment on the Commissioner's ordinary duties in these circumstances
- (b) the Commissioner has the power to assess or make decisions as to whether [the Applicant's] Registered Activities consisted of eligible R&D activities as defined in Division 355 of the ITAA 1997, in circumstances where no such findings have been made by the Board. This is consistent with the Commissioner's general administrative power and duty to assess the taxpayers' liability according to law; and,
- (c) the Tribunal has jurisdiction in the Proceeding to assess or make decisions as to whether [the Applicant's] Registered Activities consisted of eligible R&D activities as defined in Division 355 of the ITAA 1997.

Registered activities were not eligible R&D activities

In making its decision, the Tribunal considered¹ the scientific method (including hypothesis and experimentation) and the new knowledge requirements for the purposes of determining whether a registered activity is an eligible 'core R&D activity' as defined in subsection 355-25(1).

¹ At [247–686].

The Tribunal confirmed that:

- There must be sufficient evidence of scientific observation and evaluation to support a conclusion that activities are eligible R&D activities.²
- While the R&D tax incentive contemplates research being undertaken by private industry and not just institutions such as universities or other research organisations, paragraph 355-25(1)(a) requires a baseline threshold for quality and that the work must be based on principles of established science.³
- The circumstances of the Applicant were different to those addressed in the Full Federal Court decision in *Moreton Resources Ltd v Innovation and Science Australia* [2019] FCAFC 120 (*Moreton*). *Moreton* was concerned with, among other things, the application of existing technology to a new environment and whether that might satisfy the new knowledge requirement in paragraph 355-25(1)(b). The Tribunal agreed with the Commissioner's submissions that the application of existing technology to a new environment does not always satisfy the new knowledge requirement and was not the case in the Applicant's circumstances.⁴

As 'supporting R&D activities' must directly relate to one or more 'core R&D activities', the claimed supporting R&D activities failed the requirements to be supporting R&D activities under section 355-30.

Feedstock adjustment

Assuming the Applicant had engaged in R&D activities, pursuant to former section 355-465⁵, an adjustment to the Applicant's assessable income is required where, among other things, goods or materials (feedstock inputs) are 'transformed or processed during R&D activities' that produce tangible products. Broadly speaking, the feedstock adjustment is intended to reduce the effect of an R&D entity obtaining a tax offset having incurred feedstock input expenditure, to the extent it produced valuable tangible products from those inputs.

As a matter of statutory construction, the Tribunal decided the text and context of former subsection 355-465(1) do not indicate that a narrow view should be adopted as to the meaning of the words 'transformed or processed' which would limit the words to things that relate to manufacturing, fabrication or some involvement of an external agent (force or effect) being applied to an object, or that tangible products cannot be biological or agricultural. It follows that the feedstock provisions can apply to basic farming activities of growing and raising livestock and crops.⁶

The Tribunal found that the:

- 'day-old' broiler chickens
- feed that is fed to day-old broiler chickens through to their slaughter age, and
- feed that is fed to a laying broiler breeder

² At [388–400].

³ At [255].

⁴ At [378–380].

⁵ And the current section 355-445.

⁶ At [755–757], [764], [771–773].

were each transformed or processed in producing marketable feedstock outputs (broilers or fertilised eggs) during the Applicant's registered activities.⁷

Further, when calculating the feedstock adjustment, as to the meaning of 'reasonably attributable to the production of the feedstock output' for the purposes of former paragraph 355-465(2)(b), the Tribunal rejected the Applicant's alternative argument that only a portion of the poultry feed was transformed or processed to produce broilers or fertilised eggs.⁸

In making its decision, the Tribunal considered that the decision in *GHP 104 160 689 Pty Ltd and Commissioner of Taxation* [2014] AATA 869 (*GHP*) was concerned with the interpretation of a provision with significantly different wording⁹, and therefore had no bearing on the interpretation of former subsection 355-465(1).¹⁰

ATO view of decision

Jurisdiction to decide eligibility of registered activities

The decision confirms the Commissioner's view that where the Board has not made a Finding, the Commissioner has the power to make decisions about the eligibility of an R&D entity's registered activities.

Although the Commissioner has that power, where as part of ATO audit or review there are concerns about the eligibility of an R&D entity's registered activities, it has been the Commissioner's practice to refer matters to the Board for them to conduct an examination of the entity's registered activities towards making Findings. This practice will continue in the ordinary course of the Commissioner undertaking compliance work on R&D tax offset claims.

Where the Board has not made a Finding and it is not practical or possible for the Board to examine an R&D entity's registered activities and then make a Finding which binds the Commissioner within the section 355-705 time limits, there may be circumstances where it is appropriate for the Commissioner to make a decision about the eligibility of an R&D entity's registered activities, or to put the R&D entity to proof as to the eligibility of its registered activities before the Tribunal or Courts.

Registered activities were not eligible R&D activities

The Tribunal's decision is consistent with the Commissioner's view as to the requirements for an activity to be a core R&D activity under section 355-25. This will assist the Commissioner in conducting compliance work and making referrals to the Board.

Feedstock adjustment

The Tribunal's decision is consistent with the Commissioner's view as to the statutory construction of former subsection 355-465(1) and former paragraph 355-465(2)(b). The Commissioner considers that this interpretation applies equally to subsection 355-445(1) and paragraph 355-445(2)(b), the current feedstock adjustment provisions which retain identical wording.

⁷ At [774–781].

⁸ At [789–790].

⁹ That is, former section 73B(1) of the *Income Tax Assessment Act 1936*.

¹⁰ At [759].

Implications for impacted advice or guidance

The Commissioner is considering whether any changes are required to Taxation Ruling TR 2013/3 *Income tax: research and development tax offsets: feedstock adjustments* in order to provide further guidance in relation to industrial agricultural activities, and to clarify certain aspects of that Ruling which refer to the Tribunal's decision in *GHP*.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officer.

Date issued: 12 April 2024

Contact officer details have been removed as the comments period has expired.

Legislative references

ITAA 1997 Div 355
ITAA 1997 355-25(1)
ITAA 1997 355-25(1)(a)
ITAA 1997 355-25(1)(b)
ITAA 1997 355-30
ITAA 1997 355-445(1)
ITAA 1997 355-445(2)(b)
ITAA 1997 former 355-465
ITAA 1997 former 355-465(1)
ITAA 1997 former 355-465(2)(b)
ITAA 1997 355-705
ITAA 1936 former 73B(1)
IR&D Act 27B
IR&D Act 27J
IR&D Act 28E

Case references

GQHC and Commissioner of Taxation [2024] AATA 409
Commissioner of Taxation v Auctus Resources Pty Ltd [2021] FCAFC 39; 2021 ATC 20-782; 112 ATR 859; 284 FCR 294
GHP 104 160 689 Pty Ltd and Commissioner of Taxation [2014] AATA 869; 99 ATR 955
Moreton Resources Ltd v Innovation and Science Australia [2019] FCAFC 120; 2019 ATC 20-700; 110 ATR 248; 271 FCR 211

Relevant Ruling / Determination

TR 2013/3

ATO references

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