TR 92/2 - Income tax: scientific research - the application of section 73A

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Taxation Ruling
Income tax: scientific research - the application of section 73A

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Relying on this Ruling

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

[Note: This is a consolidated version of this document. Refer to the Legal database (ato.gov.au/law) to check its currency and to view the details of all changes.]

What this Ruling is about

1. This Ruling explains what types of expenditure incurred on scientific research are deductible under subsection 73A(1) of the *Income Tax Assessment Act 1936* (the Act).

1A. All legislative references in this Ruling are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

Ruling

2. Income tax deductions should be allowed under subsection 73A(1) if the expenditure is not allowable under any other section of the Act. Deductions under the subsection are allowable only for:

- payments to approved research institutes (as defined) for scientific research related to the taxpayer's business - in general, contract research payments;
- payments to approved research institutes (as defined) that have as their object the undertaking of scientific research related to the taxpayer's class of business; or
- expenditure of a capital nature incurred by the taxpayer in conducting its own research related to its own business.

No deduction is allowable under the subsection for payments to conduct research made to bodies other than approved research institutes.

Date of effect

3. This Ruling applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued.

Explanations

4. Since the enactment of section 73A in 1946, taxpayers have been able to claim tax deductions for expenditure on scientific research that would not have been allowed under another provision of the Act. Various criteria need to be satisfied before a deduction is allowed.

Allowable deductions

5. Section 73A has four categories of expenditure that are allowable deductions. They are:

(i) payments made to approved research institutes;

(ii) expenditure of a capital nature on scientific research related to that business;

(iii) plant expenditure if the plant is used for scientific research; and

(iv) capital expenditure on buildings.

Only deductions allowable under subsection 73A(1), that is categories (i) and (ii) above, are discussed in this Ruling.

6. Subsection 73A(1) states:

> 'The following **payments made**, and **expenditure incurred**, during the year of income (other than any amount which is allowable as a deduction under any other section of this Act) by a person carrying on a business for the purpose of gaining or producing assessable income shall be allowable deductions -
>
> (a) **Payments to** -
>
> (i) an approved research institute for scientific research related to that business; or
>
> (ii) an approved research institute, the object of which is the undertaking of scientific research related to the class of business to which that business belongs; and
>
> (b) **Expenditure** of a capital nature **on** scientific research related to that business (except to the extent that it is expenditure on plant, machinery, land or buildings or on alterations, additions or extensions to buildings or in the acquisition of rights in or arising out of scientific research).'

As can be seen the subsection is broken up into **two** parts – payments made and expenditure of a capital nature.

Payments made

7. There are two sorts of deductible payments. Both sorts of payments, like other deductions under the section, can only be claimed by a person carrying on a business for the purpose of gaining or producing assessable income. (Taxpayers who derive assessable income but don't carry on a business can't claim a deduction under the section for either sort of payment.) Both sorts of payments must be made to an approved research institute.

8. Payments for scientific research related to the taxpayer's own business (or one of the payer's own businesses) are deductible under subparagraph 73A(1)(a)(i). Those payments will generally be contractual: otherwise, the payments will be unlikely to be for work relating to the particular business of the payer.

9. Payments to an institute which has as its object the undertaking of scientific research related to the taxpayer's class of business are deductible under subparagraph 73A(1)(a)(ii). These payments will generally be in the nature of dues to a trade association that is an approved research institute, or a payment that is in exchange for some significant advantage to the payer (for instance, access to research results that would not generally be available).

10. Gifts made to approved research institutes that are endorsed as deductible gift recipients for the purposes of scientific research in the field of natural or applied science would generally be deductible under Division 30 of the *Income Tax Assessment Act 1997.*

Approved research institutes

11. The Commonwealth Scientific and Industrial Research Organisation (CSIRO) is an approved research institute. So are any universities, colleges, institutes, associations or organisations approved in writing for the purposes of section 73A. Bodies may be approved by the CSIRO, the Chief Executive Officer of the National Health and Medical Research Council and the Secretary of the Department administered by the Minister administering the *Australian Research Council Act 2001* (as at November 2024, the Secretary of the Department of Education). The bodies are approved as being for undertaking scientific research which is or may prove to be of value to Australia.

Expenditure of a capital nature

12. Paragraph 73A(1)(b), relates to **'expenditure of a capital nature on scientific research related to that business'.** Interpretation of the quoted phrase in the context of the entire section has led to conflicting

views as to what is actually intended to be deductible under this particular category.

13. We consider that paragraph 73A(1)(b) refers to scientific research of an in-house nature (i.e. scientific research conducted by the taxpayer itself) and does not extend to contract payments to non-approved research institutes for scientific research (i.e. other members of a group company structure or other entities). This view has been reached having regard to:

- the construction of the section;
- statutory interpretation and case law;
- the Explanatory Memorandum (EM) accompanying Act No. 6 of 1946 which inserted section 73A;
- the Second Reading Speech accompanying the Bill; and
- Canberra Income Tax Circular Memorandum No. 519 (CITCM 519) issued in 1946.

Construction of section

14. As stated at paragraph 6 of this Ruling, an examination of subsection 73A(1) reveals that it is broken into two separate parts. Paragraph (a) relates to **payments** made for contractual work performed or dues to trade associations. Paragraph (b) relates to **capital expenditure** that is incurred by the taxpayer itself from its own research activities. Contract payments to entities other than approved research institutes to conduct scientific research are not allowable under section 73A.

The mischief caused

15. Upon a reading of paragraph 73A(1)(b) in isolation, it could be concluded that the paragraph refers to any expenditure including contract payments on scientific research related to that business. However, that would lead to an absurd and inconsistent result when looked at in the light of the entire section. Paragraph (b) refers to expenditure **on** scientific research and not **for** scientific research. If contract payments were intended to be allowable under the paragraph then why was the word 'on' used instead of 'for' as was used in paragraph (a)?

16. Further, if contract payments made to non-approved research institutes were allowable under paragraph 73A(1)(b) then what is the purpose of:

- the requirement in paragraph 73A(1)(a) that only payments made to approved research institutes are allowable deductions;

- the test that the research payments, to be allowable, must be paid to an institution, association or organisation for undertaking scientific research **which may prove to be of value to Australia** (subsection 73A(6));
- paragraph 73A(7)(a) (i.e. to give the benefit of the section in cases where an institution has not been approved but presently will); and
- paragraph 73A(7)(b) (i.e. the power to withdraw approved research institute status so as to prevent deductions being claimed by taxpayers making payments to institutes no longer entitled to be regarded as an institute for scientific research)?

For these reasons, we consider that the intention of the legislation is that only contract payments made to **approved** research institutes are allowable under section 73A. Paragraph 73A(1)(b) is intended to only allow capital expenditure incurred by the taxpayer itself on scientific research.

Statute interpretation

17. It is a well established common law doctrine that in interpreting a statute which is not clear, one should look to the words surrounding the provision and not look at the provision in isolation. The mischief rule as approved in *Federated Engine-Drivers and Firemen's Association of Australasia Claimants; and Broken Hill Proprietary Company Limited* [1911] HCA 31; 12 CLR 398, at 439 requires that regard should be had as to why an Act was passed.

18. The golden rule, as approved in *Australian Boot Trade Employes' Federation Claimants; and Whybrow and Co* [1910] HCA 53, provides that where there is an absurdity and inconsistency in an Act, the Court will take into account the consequences of a particular interpretation and where two possible interpretations are open, one reasonable and one absurd, the court will choose the former.

See also *Ingham v Hie Lee* [1912] HCA 66.

19. Section 15AA of the *Acts Interpretation Act 1901* states that:

> In interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose or object is expressly stated in the Act) is to be preferred to each other interpretation.

20. Applying the above discussion to section 73A, the interpretation of the section should reflect the intention of the legislation and not produce an absurdity or inconsistency. This can only be achieved by interpreting the phrase **'expenditure of a capital nature related to that business'** as meaning expenditure incurred by the taxpayer on

scientific research it conducts itself and not contributions or other payments made to another entity to conduct scientific research.

Explanatory Memorandum

21. Subsection 15AB(1) of the *Acts Interpretation Act 1901* states that extrinsic material may be used so as to ascertain the intentions of the legislators. This material includes Explanatory Memorandums. An examination of the EM to Act No. 6 of 1946 introducing section 73A explains that paragraph 73A(1)(b) is to apply to unsuccessful research expenditure of a capital nature such as the cost of unsuccessful efforts to produce a new type of plant or product. Other than this, it is silent on the issue.

22. However, examining the EM to understand other functions of the section shows the function of paragraph 73A(1)(b). The function of subsection 73A(7) described in the EM includes giving taxpayers the benefit of the section in cases in which amounts are paid to institutions for the purposes of scientific research before those institutions are formally approved as approved research institutes. This would be a meaningless function if such expenditure is allowable under paragraph 73A(1)(b). Also, the EM states that subsection 73A(7) is designed to prevent deductions if the activities of an institution have changed to such an extent that it is no longer entitled to be regarded as an institute for scientific research. Again, that function can not be fulfilled if contract expenditure is allowable as a deduction under paragraph 73A(1)(b).

Second Reading Speech

23. The Prime Minister and Treasurer, Mr Chifley, stated in the Second Reading Speech introducing the Bill that:

> 'Under these proposals, certain research expenditure of a capital nature will be allowed as a deduction. In addition, payments to an approved research institute will be allowed as a deduction provided the research is related to the business of the taxpayer' (emphasis added).

Clearly, only **certain** research expenditure of a capital nature was to be allowable. This did not include **payments** other than those made to an approved research institute.

Board and court decisions

24. Decisions concerning section 73A are not numerous and specific reference to the operation of paragraph 73A(1)(b) is scarce. However,

in the Commonwealth Taxation Board of Review case 18 CTBR (N.S.) Case 51, member Mr O'Neill at page 364 stated that:

> 'broadly speaking (1)(b) covers what might be called the operational expenses involved in the carrying on of scientific research - research workers' salaries and fees, the cost of supplies used in research, the repair and maintenance of equipment etc.'

That is, the Board regarded paragraph 73A(1)(b) as being concerned with expenses that are incurred by the taxpayer itself conducting scientific research.

25. In the case of *Goodman Fielder Wattie Ltd v Commissioner of Taxation* [1991] FCA 264 at 36, Hill J stated, *obiter* (emphasis added):

> '…The evident purpose of s.73A was to grant a concession to taxpayers in cases where expenditure was not otherwise deductible, for example, if it was of a capital nature. To qualify, the expenditure must be for scientific research, whether that expenditure is made to an approved research institute (s.73A(1)(a)) or is expenditure incurred by the taxpayer itself on scientific research.'

That is, Hill J regarded paragraph 73A(1)(b) as relating to expenditure incurred by the taxpayer **itself** on scientific research. By inference, payments to approved research institutes are therefore not regarded by Hill J as expenditure incurred by the taxpayer itself on scientific research. It follows therefore that payments to non-approved research institutes are also not expenditure incurred by the taxpayer itself on scientific research and hence not deductible under paragraph 73A(1)(b).

Office interpretation

26. The Commissioner commented on section 73A in CITCM 519 of 1946. This memorandum was released to explain the new provision shortly after the legislation was enacted. Only research activities conducted by the taxpayer itself are used to explain the purpose of paragraph 73A(1)(b). The memorandum is not explicit on whether contract payments to entities other than approved research institutes are allowable deductions. However, in discussing approved research institutes, the memorandum implies that payments to other than approved research institutes are not allowable under section 73A (see paragraph 16 of this Ruling).

Commissioner of Taxation

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legislative references
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- Acts Interpretation Act 1901 15AA; Acts Interpretation Act 1901 15AB(1)
- Australian Research Council Act 2001

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- Goodman Fielder Wattie Ltd v. Commissioner of Taxation [1991] FCA 264; 91 ATC 4438; 22 ATR 26; 101 ALR 329
- Commonwealth Taxation Board of Review 18 CTBR (N.S.) Case 51; 72 ATC 480
- Ingham v. Hie Lee [1912] HCA 66; 15 CLR 267; [1913] VLR 221; 18 ALR 453
- Federated Engine-Drivers and Firemen's Association of Australasia Claimants; and Broken Hill Proprietary Company Limited [1911] HCA 31; 12 CLR 398; 17 ALR 285
- Australian Boot Trade Employes' Federation Claimants; and Whybrow and Co [1910] HCA 53; 11 CLR 311; 16 ALR 513