Australian Government
Australian Taxation Office

ATO Interpretative Decision

ATO ID 2003/990

Income Tax
Research and Development: additional deduction for incremental expenditure where a group member company has a substituted accounting period

FOI status: may be released
Status of this decision: Decision Current

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Issue

If an eligible company is grouped with another company that has a different accounting period, is the 'year of income' referred to in paragraph (b) of the definition of 'R&D spend' in subsection 73P(2) of the *Income Tax Assessment Act 1936* (ITAA 1936) that of the eligible company, and not that of the group member?

Decision

Yes. The eligible company's 'year of income' is used when calculating an amount under paragraph (b) of the definition of 'R&D spend' in subsection 73P(2) of the ITAA 1936, for the purposes of sections 73U, 73V, 73W and 73Y of the ITAA 1936.

Facts

The company is an 'eligible company', as defined in subsection 73B(1) of the ITAA 1936. It undertakes research and development activities in Australia and is examining its entitlement under section 73Y of the ITAA 1936 to an additional deduction relating to 'incremental expenditure', as defined in subsection 73P(2) of the ITAA 1936, for a year of income (referred to as the 'deduction year' in subsection 73Q(1) of the ITAA 1936).

The eligible company has a normal Australian accounting period ending on 30 June. It satisfies the requirements in subsection 73Q(1) of the ITAA 1936 to be entitled to an additional deduction under section 73Y of the ITAA 1936.

The eligible company is grouped with another company under section 73L of the ITAA 1936.

The company which is grouped with the eligible company, has a substituted accounting period, and lodged a transitional return (covering income and deductions relating to a period greater than 12 months), for the period equating to the year of income immediately prior to the deduction year.

Reasons for Decision

Calculation of the amount of the additional deduction allowable under section 73Y of the ITAA 1936 requires working out the eligible company's 'premium amount' under section 73W of the ITAA 1936, as well as any apportionment of the premium amount under section 73X of the ITAA 1936.

It is not possible however, to calculate the premium amount without also calculating the eligible company's 'running average' for the deduction year, under section 73U of the ITAA 1936. In section 73U of the ITAA 1936 the deduction year is referred to as the 'Y0 year of income', which 'is the year of income for which an eligible company is working out its assessable income and deductions' (refer to the definitions of particular years of income identified by 'Y' and a further identifier in subsection 73P(6) of the ITAA 1936).

In order to work out the eligible company's premium amount for the Y0 year of income, under section 73W of the ITAA 1936, it needs to calculate, for this year of income, its:

- R&D spend
- running average; and
- any 'adjustment balance', as calculated under section 73V of the ITAA 1936.

Under subsection 73U(1) of the ITAA 1936, calculation of the eligible company's running average requires calculating one third of the sum of its R&D spend for each of the 'Y-1', 'Y-2', and 'Y-3' years of income. The 'Y-1' year of income of the eligible company is the year of income immediately before the Y0 year of income, the 'Y-2' year of income is the year of income 2 years before, and the 'Y-3' year of income is the year of income 3 years before, as in the definitions in subsection 73P(6) of the ITAA 1936.

The definition of R&D spend in subsection 73P(2) of the ITAA 1936 is therefore critical to the calculation of the amount of the additional deduction allowable under section 73Y of the ITAA 1936. This definition states:

> R&D spend of an eligible company for a **year of income** means the sum of:
>
> the incremental expenditure of the eligible company for the year of income incurred during its group membership period; and
>
> the incremental expenditure of **each group member** of the eligible company **for the year of income** incurred during its group membership period.' [emphasis added]

In this case, there is another company which is a group member of the eligible company. This other company has a substituted accounting period, which means that, unlike the position of the eligible company, its year of income ends on a date other than 30 June (refer to section 18 of the ITAA 1936, and the subsection 6(1), ITAA 1936 definition of year of income). As well, this other company, as a condition of being allowed to adopt the substituted accounting period, has lodged a return of income for a period greater than 12 months, in relation to the comparable year immediately before the eligible company's deduction year or Y0 year of income.

Two questions therefore arise:

(1) whose year of income is used in calculating the incremental expenditure of the group member under paragraph (b) of the definition of R&D spend; and

(2) can this year of income for any of Y-1, Y-2, or Y-3, be a period of less than 12 months.

A key feature of the scheme of sections 73Q to 73Y, in calculating the amount of any additional deduction relating to changes in incremental expenditure when compared to a running average, concerns examining the position of the eligible company. Consistent with this scheme is the fact that when the term 'year of income' is used in the definition of R&D spend, it refers to the year of income of the eligible company (for example, in section 73W of the ITAA 1936, the R&D spend for the 'Y0' year of income is referred to, and the 'Y0' year of income is that of the eligible company in paragraph 73P(6)(a) of the ITAA 1936).

Therefore, the year of income to be used each time in calculating the relevant amount of R&D spend of the group member, is that of the eligible company. The substituted accounting period of the group member will not be relevant when the eligible company is calculating the amount it claims as an additional deduction under section 73Y of the ITAA 1936.

The meaning of 'year of income' in this context means the same as it does elsewhere in the ITAA 1936, that is, a period of 12 months (see *Norwich Superannuation Services Pty Ltd v. F C of T* (1998) 41 ATR 1091; 99 ATC 2015).

Note: The same result would also arise if the group member, lodged a return of income for the comparable year of the eligible company's deduction year or any of the three prior years for a substituted accounting period or a period greater than or less than 12 months.

Date of decision: 10 October 2003

Year of income: Year ended 30 June 2003
Year ended 30 June 2002

Legislative References:
Income Tax Assessment Act 1936
subsection 6(1)
section 73B
subsection 73B(1)
section 73L
section 73P
subsection 73P(2)
subsection 73P(6)
section 73Q
subsection 73Q(1)
section 73U
section 73V
section 73W
section 73X
section 73Y

Case References:
Norwich Superannuation Services Pty Ltd v. FC of T
(1998) 41 ATR 1091
99 ATC 2015

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