



## ATO Interpretative Decision


ATO ID 2004/702

### Income tax

### Research and Development: 'R&D group turnover' - value of supplies made in the year of income - interest payments

FOI status: may be released

Status of this decision: Decision Current

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## Issue

In calculating the 'value of supplies' under paragraph 73K(1)(b) of the definition of 'R&D group turnover', in the *Income Tax Assessment Act 1936* (ITAA 1936), for a company that conducts business as a lender, are amounts of interest in respect of loans that were settled in a prior year of income, as well as interest in respect of loans that were settled in the current year of income, included?

## Decision

Yes. The 'value of supplies' under paragraph 73K(1)(b) of the definition of 'R&D group turnover' in the ITAA 1936, for the relevant year of income, includes the amount of interest receivable by the company on all outstanding loans, regardless of when those loans were written.

## Facts

The taxpayer is an 'eligible company' as defined in subsection 73B(1) of the ITAA 1936. It undertook 'research and development activities' (as defined in subsection 73B(1) of the ITAA 1936) in the 2003 year of income. The eligible company incurred expenditure on these activities.

The eligible company was grouped with another company in the manner described in section 73L of the ITAA 1936 during the relevant year of income.

Under section 73K of the ITAA 1936, when determining its 'R&D group turnover', the eligible company was required to include 'the value of supplies made in the year of income by other persons while they were grouped with the company'.

In the relevant year of income, the company grouped with the eligible company in the manner described in section 73L of the ITAA 1936, acted as a lender providing mortgage loans.

During the relevant year of income, the company grouped with the eligible company received, on a monthly basis, interest payments from borrowers in respect of Settled Loans that were written both during the relevant income year, and during earlier years of income, that were not discharged.

## Reasons for Decision

Section 73I of the ITAA 1936 provides that an eligible company can choose a tax offset rather than a deduction for research and development expenditure.

Section 73J of the ITAA 1936 provides that an eligible company can only choose the tax offset if:

- it would have been entitled to a deduction under sections 73B, 73BA, 73BH or 73Y of the ITAA 1936;
- the company's aggregate research and development amount exceeds \$20,000 for the income year;
- the aggregate research and development amount for the company and other taxpayers with which it is grouped is not more than \$1,000,000; and
- the R&D group turnover for the year is less than \$5,000,000.

'R&D group turnover' of an eligible company for a year of income is defined in section 73K of the ITAA 1936 and subsection 73K(1) of the ITAA 1936 provides that it is the sum of:

- (a) the value of the supplies the company made in the year of income; and
- (b) the value of the supplies made in the year of income by other persons while they were grouped with the company; ...

'Value of the supplies' is defined in subsection 73H(2) of the ITAA 1936 as including supplies (both taxable and other) made during the year in the course of carrying on a business or in the course of carrying on research and development activities. The value of taxable supplies and prices of other supplies are as defined by section 9-75 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Section 40-5 of the GST Act provides that a financial supply is input taxed, and that the meaning of what is a financial supply is covered in the regulations. Financial supplies are not taxable supplies, and will thus, be 'other supplies', for the purposes of section 73K of the ITAA 1936.

Regulation 40-5.09 of the GST Act provides the criteria for a financial supply, including that there be either a **provision, acquisition or disposal** of an interest mentioned in either subregulation (3) or (4). Item 2 in subregulation (3) specifies that a relevant interest will be 'An interest in or under ... a debt, credit arrangement or right to credit, including a letter of credit'. 'Credit arrangement' is not defined in either the GST Act or the GST Regulations.

The Commissioner's view of a 'financial supply' is outlined in Goods and Services Tax Ruling GSTR 2002/2. Paragraphs 37 to 42 of that ruling discuss what will be consideration relating to a loan. Paragraph 37 of GSTR 2002/2 says:

When an entity borrows money from a lender on terms that include payment of interest, it creates an interest in a debt that includes the payment of interest. **The lender creates and supplies an interest in a credit arrangement.** ... (emphasis added)

Schedule 2 to GSTR 2002/2 sets out certain details pertaining to financial interests and related supplies by

financial supply providers and financial supply facilitators. Note 1 to this Schedule states:

Fees, charges and payments received or charged for a supply are generally regarded as consideration (or part of the consideration) for a financial supply rather than a financial supply themselves. For example, *interest* payable on money loan or deposited is generally regarded as **part of the consideration for the use of money** (a debt). (emphasis added)

Subsection 73K(3) of the ITAA 1936, provides that the face value of the debt representing the amount borrowed, being, the loan 'principal', is disregarded for the purposes of calculating the R&D group turnover.

Notwithstanding that the relevant GST regulations appear to identify the provision of a financial supply as a one-off event, they do not rule out the possibility that allowing a borrower to participate in a credit arrangement, can be a **provision** of an **interest** to that borrower on an ongoing basis. Therefore, for the purposes of section 73K of the ITAA 1936 and the meaning of 'R&D group turnover', the relevant supply is both made at the start of the loan agreement and continues to be made until that agreement ends.

In accordance with section 73K of the ITAA 1936 and the section 73H of the ITAA 1936 definition of the value of the supplies, in this case the interest accrued on loans outstanding for a year of income, is the relevant amount that is included in 'R&D group turnover', irrespective of when the loans were first entered into. The supply is the ongoing use of the money lent to the borrowers, and the interest received by the company grouped with the eligible company represents consideration for these continual supplies, reflecting the ongoing nature of the supplies being made. The ongoing supplies are to be distinguished from the initial provision of those monies at the time at which the credit arrangement is entered into.

Accordingly, the 'value of supplies made' under section 73K of the ITAA 1936 by the other company in the relevant year of income, includes the interest accrued on loans outstanding for the relevant year of income, irrespective of when the loans were entered into by this company. It is this amount that is used in calculating the 'R&D group turnover' under section 73K of the ITAA 1936 for the purposes of determining the eligible company's entitlement to the research and development tax offset under section 73J of the ITAA 1936.

Paragraph 73K(3)(b) of the ITAA 1936 provides that 'R&D group turnover' will not include any repayment of principal in relation to supplies constituted by loans.

**Date of decision:** 19 July 2004

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

#### **Legislative References:**

##### *Income Tax Assessment Act 1936*

- section 73K
- subsection 73K(1)
- subsection 73K(3)
- paragraph 73K(1)(b)
- paragraph 73K(3)(b)
- section 73B
- subsection 73B(1)
- section 73I
- section 73J
- section 73L
- section 73BA
- section 73BH
- section 73Y
- section 73H
- subsection 73H(2)

##### *A New Tax System (Goods and Services Tax) Act 1999*

- section 9-75
- section 40-5

##### *A New Tax System (Goods and Services Tax) Regulations 1999*

- regulation 40-5.09

**Related Public Rulings (including Determinations)**

Goods and Services Tax Ruling GSTR 2002/2

**Related ATO Interpretative Decisions**

ATO ID 2003/343

ATO ID 2004/701

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