Australian Government
Australian Taxation Office

ATO Interpretative Decision

ATO ID 2006/74

Income Tax
Research and Development: subsection 73B(3B) - partnership

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

CAUTION: This is an edited and summarised record of a Tax Office decision. This record is not published as a form of advice. It is being made available for your inspection to meet FOI requirements, because it may be used by an officer in making another decision.

This ATOID provides you with the following level of protection:

If you reasonably apply this decision in good faith to your own circumstances (which are not materially different from those described in the decision), and the decision is later found to be incorrect you will not be liable to pay any penalty or interest. However, you will be required to pay any underpaid tax (or repay any over-claimed credit, grant or benefit), provided the time limits under the law allow it. If you do intend to apply this decision to your own circumstances, you will need to ensure that the relevant provisions referred to in the decision have not been amended or repealed. You may wish to obtain further advice from the Tax Office or from a professional adviser.

Issue

Is there a 'partnership' under subsection 73B(3B) of the *Income Tax Assessment Act 1936* (ITAA 1936), where two companies collaborate to conduct research and development activities, and to engage the services of a third to conduct some of these activities on their behalf?

Decision

Yes. The collaboration between the two companies results in a 'partnership' under subsection 73B(3B) of the ITAA 1936, as the joint conduct of the research and development activities is 'taken to constitute carrying on business with a view to profit'.

Facts

The taxpayers are both eligible companies (as defined in subsection 73B(1) of the ITAA 1936), jointly conducting a project of research and development (R&D) activities.

These two companies engage a third company (researcher co), to carry out some of the R&D activities on their behalf. Part of the terms and conditions under which researcher co is engaged involve it contributing to a pool to fund some of these activities, as well as supplying certain of its own intellectual property towards the conduct of some of the research in question.

The two eligible companies agree to share in the results of the R&D activities, as well as in the net proceeds from any commercial exploitation of those results. Under this agreement, which is separate from that under which researcher co is engaged, each company acts as agent for the other in the conduct of the activities and mutual rights and obligations between the two eligible companies are created. However, the agreement between them and researcher co does not give rise to any mutual rights and obligations between those parties.

In the years of income in question no commercial exploitation of any results of the R&D activities occurs.

Reasons for Decision

Subsection 73B(3B) of the ITAA 1936 states:

> In determining whether a relationship between persons for the purpose of engaging in research and development activities constitutes a partnership for the purposes of this Act, the engaging by those persons in those activities is to be taken to constitute carrying on business with a view to profit.

Subsection 6(1) of the ITAA 1936 provides that 'partnership' has the same meaning as in the *Income Tax Assessment Act 1997* (ITAA 1997), and that the term 'this Act', includes the ITAA 1997.

In subsection 995-1(1) of the ITAA 1997 the term 'partnership' is relevantly defined to mean:

> **(a)** an association of persons (other than a company or a *limited partnership) carrying on business as partners ... [not otherwise relevant].

At the time subsection 73B(3B) of the ITAA 1936 was introduced in 1989, the definition of 'partnership' was in this Act, and relevantly read:

> partnership means an association of persons carrying on business as partners ... [not otherwise relevant].

The strong similarity between the two definitions of 'partnership' is evident. The former definition has been held to embody the common law meaning of partnership, which is an association of persons carrying on business in common with a view to profit (*Rose v. Federal Commissioner of Taxation* (1951) 83 CLR 118; (1951) 9 ATD 334; (1951) 5 AITR 197 (Rose)).

The Explanatory Memorandum to Taxation Laws Amendment Bill (No 4) 1989, in relation to the introduction of subsections 73B(3A) and 73B(3B) into the ITAA 1936, stated at page 8:

> The Bill will ensure that partners in a partnership of otherwise eligible companies will not be denied the special deduction for expenditure on R&D activities. This will remove a doubt that has been expressed over the present law to the effect that such companies are not eligible for the deduction on the basis that it is the partnership, rather than the partner companies, which incurs the expenditure.
>
> The concept of a 'partnership' for this purpose will not be limited to more common concepts of a partnership; the fact that the companies are not carrying on business with a view to profit will not preclude acceptance that a partnership exists for the purposes of the amendment.

The above passage is consistent with the decision in Rose, in recognising that the requirement of carrying on business in common with a view to profit was already part of the then existing definition of 'partnership'. However, the last sentence in this passage also demonstrates that the amendment to be brought about by subsection 73B(3B) of the ITAA 1936, was to deem the existence of a 'partnership', in situations where this condition was not met, but there was the engaging in R&D activities jointly by otherwise eligible companies.

The passage quoted above also illustrates that the context of the amendment was one in which other elements of the common law concept of partnership would exist, such as the relationship of agency and the presence of mutual rights and obligations (see the authorities referred to in *The Duke Group Ltd (in liq) v. Pilmer & ors* [1999] SASC 97 at [920] to [956]), and the only factor affecting the categorisation of the association between the companies as a partnership was the absence of carrying on business with a view to profit.

Put another way, this context does not support any broader interpretation of subsection 73B(3B) of the ITAA 1936, that would deem all relationships between eligible companies for the purpose of engaging in research and development as partnerships 'for the purposes of this Act'. There is no suggestion, for example, that the fact that one eligible company might engage another to conduct R&D activities on its behalf was intended to make the two of them members of a deemed partnership.

Here, the two eligible companies would be a partnership at common law, (and hence under the relevant part

quoted above of the definition of 'partnership' in subsection 995-1(1) of the ITAA 1997), but for the fact that they do not in the years in question, carry on business in common with a view to profit. Under subsection 73B(3B) of the ITAA 1936 the fact that they engage jointly in the conduct of R&D activities means that in determining whether their relationship concerning this conduct is a 'partnership', the engaging together in the conduct of these activities is taken to be the carrying on of a business with a view to profit.

Hence, because of the operation of subsection 73B(3B) of the ITAA 1936, the two eligible companies come within the definition of 'partnership' in the ITAA 1997.

Researcher co stands in a different position. Although in one respect connected with the conduct of the R&D activities as a contract researcher, its relationship with the two eligible companies is materially different from that between these companies. Most importantly, the elements of mutuality and agency that exist between partners are not to be found in the relationship between the two eligible companies and researcher co. Under subsection 73B(3B) of the ITAA 1936, researcher co is not a member of the partnership deemed to exist between the two eligible companies.

Note: the conclusion that the two eligible companies are members of a partnership because of the operation of subsection 73B(3B) of the ITAA 1936, means that the calculation of their deductions for the expenditure of the partnership on the R&D activities, occurs under subsection 73B(3A) of the ITAA 1936.

Date of decision: 15 March 2006

Year of income: Year ended 30 June 2004
Year ended 30 June 2005
Year ended 30 June 2006

Legislative References:
Income Tax Assessment Act 1936
subsection 73B(1)
subsection 73B(3A)
subsection 73B(3B)
subsection 6(1)

Income Tax Assessment Act 1997
section 995-1

Case References:
Duke Group Ltd (in liq) v. Pilmer & ors
[1999] SASC 97

Rose v. Federal Commissioner of Taxation
(1951) 84 CLR 118
(1951) 9 ATD 334
(1951) 5 AITR 197

Keywords
Research & development expenditure by partnerships

Date of publication: 24 March 2006

ISSN: 1445-2782