Australian Government
Australian Taxation Office

ATO Interpretative Decision

ATO ID 2010/74

Income Tax
R&D tax concession: meaning of 'primarily' in paragraph 73B(14C)(c) of the Income Tax Assessment Act 1936

FOI status: may be released

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Issue

Can the requirement in paragraph 73B(14C)(c) of the *Income Tax Assessment Act 1936 (* ITAA 1936), that activities need to be carried on 'wholly or primarily on behalf of the foreign company' be met, where the relevant activities are not carried out by the eligible company solely on behalf of the foreign company?

Decision

Yes. The requirement in paragraph 73B(14C)(c) of the ITAA 1936 can be met if the R&D activities are carried on chiefly or mainly on behalf of the foreign company.

Facts

Company A is a 'foreign company', as defined in subsection 73B(1) of the ITAA 1936.

Company B is an 'eligible company' for the purposes of subsection 73B(1) of the ITAA 1936, and a wholly owned subsidiary of Company A.

Company B carries out certain activities which come within the definition of 'Australian-centred research and development activities' in subsection 73B(1) of the ITAA 1936.

Company A retains all of the intellectual property (IP) generated from these Australian-centred research and development activities that are carried out by Company B.

Company A pays Company B a fee equal to the costs incurred on carrying out these activities, plus an agreed mark-up.

Paragraphs (a) and (b), and (d) to (g) (inclusive), of subsection 73B(14C) of the ITAA 1936, are all satisfied in relation to Company B's expenditure.

Company B has registered its R&D activities with Innovation Australia for the relevant year of income.

An agreement exists between Company A and Company B under which the parties will cooperate to fund, develop and licence the results from carrying out the activities in question. Under the agreement, Company A has the right to commercially exploit or otherwise use these results, except in certain limited situations in which it can allow Company B to do so without any fee being charged.

Company A initiated this agreement and stipulated the scope of the activities to be carried out in accordance with its terms.

Reasons for Decision

An eligible company may claim a deduction under subsection 73B(14C) of the ITAA 1936 for expenditure on foreign owned R&D where the prerequisites of that subsection are met.

Paragraph 73B(14C)(c) of the ITAA 1936 requires that expenditure incurred by an eligible company, Company B, for the purpose of carrying on of Australian-centred R&D activities, be on activities carried on 'wholly or primarily on behalf of the foreign company', Company A, as identified under paragraph 73B(14C)(a) of the ITAA 1936: that is, a foreign company with which the eligible company is grouped with at the time the expenditure is incurred.

As Company B may benefit in some situations from the conduct of the activities in question, it cannot be said that they are carried on 'wholly on behalf of' the foreign company, Company A. The question then becomes whether nevertheless it can be concluded that these activities are carried on 'primarily on behalf of' the foreign company, Company A. There is no direct authority on this point.

In *Parker Pen (Aust) Pty Ltd v. Export Development Grants Board (* 1983) 67 FLR 234; (1983) 46 ALR 612, Lockhart J considered the meaning of the expression 'primarily and principally' for the purposes of subsection 4(1) of the *Export Market Development Grants Act 1974 (Cth).* His Honour thought that in the context in question these adverbs essentially meant the same, as 'chiefly' or 'mainly'.

The decision provides some guidance to the meaning of paragraph 73B(14C)(c) of the ITAA 1936. Thus, activities which are carried out 'primarily' on behalf of the foreign company will be those carried out by the eligible company chiefly or mainly on its behalf.

Factors that will be relevant in determining whether the research and development activities in question have been carried out wholly or primarily on behalf of the relevant foreign company are:

- the extent to which various benefits to be obtained from carrying out these activities are to flow to the foreign company (effective ownership),
- the extent to which this foreign company bears the financial burden of the conduct of the activities (financial risk) and
- the extent to which the foreign company gives directions as to what the activities to be carried out for it are to be, and how they are to be carried out (control).

In this case the foreign company, Company A:

- initiated the agreement under which the relevant activities are carried on, and stipulated the scope of those activities;
- bears the financial burden of the conduct of the activities;
- takes full legal ownership of IP developed from these activities, and other than in certain

limited situations, is the only entity which can commercially exploit or otherwise use that IP, and any other results obtained.

These factors all point to the Australian-centred R&D activities being carried out chiefly or mainly on behalf of the foreign company, Company A. Hence, paragraph 73B(14C)(c) of the ITAA 1936 is satisfied in this case in respect of Company B's expenditure.

Date of decision: 24 March 2010

Year of income: Year ended 31 December 2009

Legislative References:
Income Tax Assessment Act 1936
subsection 73B(14C)
subsection 73B(1)

Case References:
Parker Pen (Aust) Pty Ltd v. Export Development Grants Board
(1983) 67 FLR 234
(1983) 46 ALR 612

Related Public Rulings (including Determinations)
Class Ruling CR 2009/45

Other References
Guide to the R&D Tax Concession Part C Expenditure on Research and Development

Keywords
Research & development expenses
Overseas research & development expenditure
Grouped entities for research and development

Date of publication: 1 April 2010

ISSN: 1445-2782

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