



ATO Interpretative Decision

ATO ID 2014/11

Income Tax

Research and Development: building expenditure

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Issue

Does the exclusion for 'expenditure incurred in the acquisition or construction of a building' in the definition of 'research and development expenditure' in subsection 73B(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) only include structural elements that form the building?

Decision

No. 'Building' for the purposes of subsection 73B(1) of the ITAA 1936 also includes 'a part of a building. For this purpose, 'a part of a building takes on its ordinary meaning and refers to structural components of a building that make up the whole building. It also includes items that have a separate identifiable nature that nevertheless become an integral part of a building enabling the building to function as the setting for the taxpayer's income-producing activities.

Facts

The taxpayer is a construction company undertaking some research and development (R&D) in relation to its buildings. Its expenditure on the construction of the buildings is incurred on revenue account. This means that an item of the taxpayer that is trading stock cannot be a depreciating asset for the purposes of Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The construction involves the development, design, build and demonstration of a highly automated end-to-end batch manufacturing process, involving physically separate structures connected by pipes and conductors to facilitate the automated manufacturing process. Some of the structures are heavily customised to support the R&D activity, and house specialised process plant equipment.

In the year ended 30 June 2010 the taxpayer registered the construction of the structures as its R&D project with Innovation Australia under section 39J of the *Industry Research and Development Act 1986*.

The taxpayer is an eligible company as defined in subsection 73B(1) of the ITAA 1936.

Reasons for Decision

Subsection 73B(14) of the ITAA 1936 provides a concessional deduction for 'research and development expenditure' where certain conditions are met. The definition of 'research and development expenditure' in subsection 73B(1) excludes, among other things,

...expenditure incurred in the acquisition or construction of a building or of an extension, alteration or improvement to a building.

This exclusion is commonly referred to as the 'building exclusion'.

'Building' is defined in subsection 73B(1) of the ITAA 1936 as including 'a part of a building', but is not further defined in the ITAA 1936. Therefore, it takes its ordinary meaning as no contrary intention is evident: *Kennedy Cleaning Services Pty Ltd v. Petkoska* (2000) 200 CLR 286 at 304; ATO ID 2012/5 *Income tax : Research and Development : building expenditure* .

The Macquarie Dictionary (5th ed 2012 online) defines 'part', relevantly for the present purposes, as:

1. a portion or division of a whole, separate in reality, or in thought only; a piece, fragment, fraction, or section; a constituent.
2. an essential or integral attribute or quality.

Judicial consideration of the ordinary meaning of the phrase 'a part of' reveals the following key elements:

- The word 'part' ordinarily connotes something which is a constituent or a component of a whole. A part is something which is essential to complete the whole (*Re Walterscheid Australia Pty Ltd v. Collector of Customs* [1988] FCA 20; *Deputy Commissioner of Taxation v. Polaroid Australia Pty Ltd* (1971) 2 ATR 653).
- A part of a building can encompass individual architectural features, including internal features of design (*Darwin Fibreglass Pty Ltd v. Kruhse Enterprises Pty Ltd (t/as Viking Swimming Pools and Spas)* (1998) 41 IPR 649; 124 NTR 1).
- What is an 'integral part' of a building, in a practical sense, can be answered with regard to the completeness test (*Case 11/97 97 ATC 173*). That is, an item that is an integral, constituent, or component part, of the building which is essential to its function as the building in which the taxpayer's income-producing activities are conducted, and which makes up the whole, will form 'a part of that building. These include features that are commonly understood as being 'a part' of a building structure, such as the foundation, walls, roof, ceiling, and floor. So are items that are clearly absorbed by the structure of the building and form 'part of the fabric' of a building in which a taxpayer's income-producing activities are conducted, such as internal plumbing, electrical switchboards, wiring and conduits, mains and sub-mains cables, gas installations, security features, and screen doors. These items form part of the setting in which the taxpayer carries on its business activities (*Wangaratta Woollen Mills Ltd v. Federal Commissioner of Taxation* 69 ATC 4095; *Imperial Chemical Industries of Australia and New Zealand Ltd v. FCT* (1970) 120 CLR 396; *Woodward v. FC of T* [2003] AATA 4; 2003 ATC 2001).

The term 'part' of a building in its ordinary sense also includes fixtures. Additionally, part of a building can include a permanent, fixed and structurally delineated section of the building capable of being the subject of a separately identifiable legal or equitable interest, such as a single floor of a multi-storey building (Taxation Ruling TR 2013/2 *Income tax : school or college building funds*). Thus, an item that is annexed, affixed, or adjunct to the building but in such a way that it loses its separate character and becomes integral to the building forms 'part of a building' (Taxation Ruling TR 2007/9 *Income tax : circumstances when an item used to create a particular atmosphere or ambience for premises used in a cafe, restaurant, licensed club, hotel, motel or retail shopping business constitutes an item of plant* , paragraphs 8-9).

Applying the above considerations to the R&D context, it is concluded that the expression 'a part of a building' refers to both:

- parts or sections of a building which, in their ordinary sense, are essential to making up the whole structure as a building for which it is intended to be used. These include the foundation, walls, roof, ceiling, floor, and structurally delineated parts within the building such as individual rooms, and
- items that have a separate identifiable character but nevertheless become part of the fabric of the building once they are attached or affixed to the structure. These include electrical wiring, cabling and conduits, plumbing, flooring, lighting, and depreciable items that become an integral part of a building.

Whether an item becomes integral to, or part of, the fabric of the building once it is attached or affixed to the structure is a question of fact and degree, having regard to:

- whether the item visually retains a separately identity
- the degree of permanence with which it has been attached
- the incompleteness of the building without it, and
- the extent to which it was intended to be permanent or whether it was likely to be replaced within a relatively short period.

This interpretation also applies to the interpretation of the term 'a part of a building' in subparagraph 355-225(1)(a)(i) of the ITAA 1997 insofar as it applies to the R&D tax incentive program found in Division 355 of the ITAA 1997, applicable to income years commencing on or after 1 July 2011.

In the present case, as the construction involves the development, design, build and demonstration of a highly automated end-to-end batch manufacturing process, the building exclusion will apply to both the structural elements that form the physically separate structures ('buildings') and those items that have a separate identifiable nature that nevertheless become an integral part of those structures ('parts of a building'), enabling the structures to function as the setting for the automated end-to-end batch manufacturing process.

Note: As the taxpayer's construction of the buildings is on revenue account, the issue of whether an item that is not an integral part of a building could nevertheless be a depreciating asset for the purposes of Division 40 of the ITAA 1997 does not arise. An item that is trading stock of the taxpayer cannot be a depreciating asset for the purposes of Division 40 of the ITAA 1997 .

Date of decision: 4 March 2014

Year of income: Year ended 30 June 2010

Legislative References:

Income Tax Assessment Act 1936

subsection 73B(1) (now repealed)

subsection 73B(14) (now repealed)

Income Tax Assessment Act 1997

Division 40

Division 43

Division 355

subparagraph 355-225(1)(a)(i)

Case References:

Case 11/97

(1997) 35 ATR 1022
97 ATC 173

Darwin Fibreglass Pty Ltd v. Kruhse Enterprises Pty Ltd (t/as Viking Swimming Pools and Spas)
(1998) 41 IPR 649
124 NTR 1

Deputy Commissioner of Taxation v. Polaroid Australia Pty Ltd
(1971) 2 ATR 653
71 ATC 4249

Imperial Chemical Industries of Australia and New Zealand Ltd v. FCT
[1970] HCA 9
(1970) 120 CLR 396
1 ATR 450
70 ATC 4024

Re Walterscheid Australia Pty Ltd v. Collector of Customs
[1988] FCA 20

Wangaratta Woollen Mills Ltd v. Federal Commissioner of Taxation
[1969] HCA 39
1 ATR 329
69 ATC 4095

Woodward v. FC of T
[2003] AATA 4
2003 ATC 2001
51 ATR 1115

Related Public Rulings (including Determinations)

TR 2013/2
TR 2007/9

Related ATO Interpretative Decisions

ATO ID 2012/5

Other References

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