Administrative Appeals Tribunal of Australia

JLSP and Innovation Australia [2016] AATA 23 (22 January 2016)

Last Updated: 22 January 2016

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Division	GENERAL DIVISION
File Number(s)	**2014/5955**
Re	**JLSP** APPLICANT
And	**Innovation Australia** RESPONDENT

DECISION

Tribunal	**Deputy President S E Frost**
Date	**22 January 2016**
Place	**Sydney**

The Tribunal sets aside the decision under review and decides instead that:

> (a) Activity 1 referred to in Annexure A is a 'core R&D activity' within the meaning of s 355-25(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).
> (b) Activities 3 and 5 referred to in Annexure A are 'supporting R&D activities' within the meaning of s 355-30(1) of the ITAA 1997.

.....[sgd].....

Deputy President S E Frost

CATCHWORDS

INDUSTRY RESEARCH AND DEVELOPMENT - whether activity is core R&D activity - clinical trials carried out to determine safety and efficacy of a drug - definition of 'core R&D activity' - whether activity conducted for the purpose of generating new knowledge –purpose must be held by applicant R&D entity - purpose of generating new knowledge not required to be the dominant purpose but must be more than an insubstantial purpose – Tribunal finds that Activity 1 is a 'core R&D activity'

INDUSTRY RESEARCH AND DEVELOPMENT – statutory construction – respondent charged with responsibility for making finding as to whether activity is core R&D activity – demarcation between definitional and operational provisions contained within Division 355 of the Income Tax Assessment Act 1997 - consideration of whether tax offsets would be available under operational provisions irrelevant to determination of whether definition of core R&D activity is satisfied

LEGISLATION

Income Tax Assessment Act 1997 ss 355-5, 355-25, 355-30, 355-705,

Industry Research and Development Act 1986 ss 6, 26, 28A, 30D, 30E

REASONS FOR DECISION

Deputy President S E Frost

22 January 2016

BACKGROUND

1. On 24 December 2015 the Tribunal published reasons for its finding that 'Activity 1' (as described below) carried on by the applicant is a 'core R&D activity' within the meaning of s 355-25(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).
2. On the same date the Tribunal also ordered that, because of the confidential nature of some of the material referred to in those reasons, that version of the reasons was not to be published beyond the parties and their legal representatives.
3. The applicant has reviewed that version of the written reasons and has suggested some minor amendments to them, so as to enable them to be published more broadly, while at the same time preserving the applicant's confidentiality. The Tribunal has considered the applicant's suggestions and agrees to amend the reasons accordingly. The original version of the reasons remains subject to the order made by the Tribunal on 24 December 2015. On the other hand the reasons in the form annexed as Annexure A, incorporating the amendments agreed to by the Tribunal, may be published without restriction.
4. Furthermore, the parties have now considered the matters raised by the Tribunal in paragraphs 61 and 62 of the original version of the reasons (and which are identical to the corresponding paragraphs of Annexure A). The parties have agreed in writing that, on the basis that Activity 1 has been found by the Tribunal to be a core R&D activity within the meaning of s 355-25(1) of the ITAA 1997, Activities 3 and 5 are supporting R&D activities within the meaning of s 355-30(1) of the ITAA 1997.
5. Therefore, and in accordance with s 42C(3) of the *Administrative Appeals Tribunal Act 1975*, the Tribunal gives effect to the terms of the parties' agreement by including a reference, in its substituted decision, to Activities 3 and 5.

I certify that the preceding 5 (five) paragraphs are a true copy of the reasons for the decision herein of Deputy President S E Frost

.....[sgd].....
Associate

Dated 22 January 2016

Dates of hearing **12 - 13 August 2015**

Counsel for the Applicant	**Mr J Hmelnitsky SC and Mr D Hume**
Solicitors for the Applicant	**Deloitte Lawyers**
Counsel for the Respondent	**Ms M Allars SC**
Solicitors for the Respondent	**King & Wood Mallesons**

ANNEXURE A

REASONS FOR DECISION

Deputy President S E Frost

(Revised on 22 January 2016 from the original version)

INTRODUCTION

1. The issue in this case is whether particular activities conducted by the applicant are "core R&D activities" within s 355-25(1) of the *Income Tax Assessment Act 1997* (the **ITAA 1997**). If they are, then they potentially give rise to notional deductions, and consequent tax offsets, in favour of the applicant for the 2013, 2014 and 2015 income tax years.
2. Although the Commissioner of Taxation has the general administration of the ITAA 1997[1], the question whether activities are "core R&D activities" is a question determined by Innovation Australia, an agency established by s 6 of the *Industry Research and Development Act 1986* (the **IRD Act**). If Innovation Australia finds that activities conducted by an entity are "core R&D activities", the Commissioner is bound by that finding for the purposes of assessing the entity's income tax liability (s 355-705 of the ITAA 1997).
3. The applicant applied to Innovation Australia for a so-called "advance finding", in relation to its activities, under s 28A of the IRD Act. The activities relate to the clinical trial of a drug. Innovation Australia found that the main activities, described in the decision document as "Activity 1", were not core R&D activities, and that the other activities, "Activity 3" and "Activity 5", were not supporting R&D activities. The applicant then sought internal review of those findings but the original decision was confirmed under s 30D of the IRD Act. The applicant has applied to the Tribunal, under s 30E of the IRD Act, for review of the internal review decision.

WHAT ARE "CORE R&D ACTIVITIES"?

4. Division 355 of the ITAA 1997 is entitled "Research and Development".
5. Section 355-5 explains the object of Division 355, as follows:

> *(1) The object of this Division is to encourage industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian economy.*
> *(2) This object is to be achieved by providing a tax incentive for industry to conduct, in a scientific way, experimental activities for the purpose of generating new knowledge or information in either a general or applied form (including new knowledge in the form of new or improved materials, products, devices, processes or services).*

6. There are two kinds of research and development (R&D) activities, "core R&D activities", and "supporting R&D activities". The Tribunal only needs to concern itself with the first kind. Section 355-25 explains what they are:

> ***355-25 Core R&D activities***

*(1) **Core R&D activities** are experimental activities:*
(a) whose outcome cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that:
(i) is based on principles of established science; and
(ii) proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and
(b) that are conducted for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services).
*(2) However, none of the following activities are **core R&D activities**:*
(a) market research, market testing or market development, or sales promotion (including consumer surveys);
*(b) prospecting, exploring or drilling for minerals or *petroleum for the purposes of one or more of the following:*
(i) discovering deposits;
(ii) determining more precisely the location of deposits;
(iii) determining the size or quality of deposits;
(c) management studies or efficiency surveys;
(d) research in social sciences, arts or humanities;
(e) commercial, legal and administrative aspects of patenting, licensing or other activities;
(f) activities associated with complying with statutory requirements or standards, including one or more of the following:
(i) maintaining national standards;
(ii) calibrating secondary standards;
(iii) routine testing and analysis of materials, components, products, processes, soils, atmospheres and other things;
(g) any activity related to the reproduction of a commercial product or process:
(i) by a physical examination of an existing system; or
(ii) from plans, blueprints, detailed specifications or publically available information;
(h) developing, modifying or customising computer software for the dominant purpose of use by any of the following entities for their internal administration (including the internal administration of their business functions):
*(i) the entity (the **developer**) for which the software is developed, modified or customised;*
*(ii) an entity *connected with the developer;*
*(iii) an *affiliate of the developer, or an entity of which the developer is an affiliate.*

7. There is no suggestion that if the relevant activity, "Activity 1", is covered by subsection (1) it may be excluded by subsection (2). Instead, the real contest between the parties is whether Activity 1 is within subsection (1) in the first place. In addition, the respondent accepts that if Activity 1 is found to be a core R&D activity, then Activity 3 and Activity 5 will qualify as supporting R&D activities.

GENERAL BACKGROUND

8. The applicant is a company that was incorporated over 20 years ago. It is the Australian-based entity in an international corporate group which I will refer to as the **Research Group**. Within that group are the ultimate holding company (**Research Holdings**) and the various subsidiaries that operate in many countries around the world, including **Research UK**, **Research US** and **Research Asia**. The group provides biopharmaceutical development services to clients.

9. Sometimes those services are provided on a global basis, to a global client. In those circumstances the global client will not enter into individual contracts with multiple national Research Group subsidiaries. Instead it will enter into a contract with one of the entities in the Research Group for the provision of global services. That Research Group entity will then enter into separate contracts with other members of the Group for the provision of the services within their respective territories.
10. The relationships between the various members of the Research Group for such a global engagement are governed by a contract (the **Group Master Agreement**) to which the members of the Group are parties. The general effect of the Group Master Agreement is as follows:

    (c) The entity contracting with the third party client is described as the **Contract Holder**. The contract is called a **Client Contract**;

    (d) The Contract Holder requests other members of the Group, **Service Providers**, to assist in the delivery of services under the Client Contract. Service Providers are not obliged to comply with a request from a Contract Holder but can decline to provide the services requested;

    (e) If the Service Provider accepts the request, then it and the Contract Holder agree on the scope of the services to be provided. Those services are then performed under the supervision and direction of the Contract Holder and of the person, the **Project Manager**, designated by the Contract Holder to oversee the performance of the services under the Client Contract;

    (f) The fee payable to the Service Provider by the Contract Holder is an amount equal to the Service Provider's estimated costs plus an agreed mark-up.
11. All data and information generated or derived by a Service Provider as a result of the performance of services under the Group Master Agreement become the exclusive property of **Research International**, a wholly-owned subsidiary of Research Holdings.
12. Ms Barbara Collins[2], the local Head of Clinical Project Management for the applicant, explained in her affidavit (Exhibit A1, at [38]-[42] and [45]):

> *... I understand that subsequent to entering into a contract with a third-party client, the [Global Project Manager (Global PM)] for the [Research Group] will be assigned to implement the contract. The [Global PM] will then consider which countries will be best placed to perform the contracted services having regard to, amongst other things, patient recruitment and research capabilities. Should Australia, and specifically [the applicant], be considered an appropriate location by the [Global PM], the [Global PM] will typically send via email to the [Australia and New Zealand team in the applicant], project-based documentation such as the [Research Group International Pricing Tool], protocols or protocol synopses, or clinical trial outlines. The Australia and New Zealand team of [the applicant] will then determine whether it is able to perform the services as requested by the [Global PM] and in accordance with the project-based documentation provided.*
>
> *Where the feasibility division in [the applicant] is of the view that it will not be able to provide the clinical research services as requested by the [Global PM], [the applicant] will decline to participate in the study. In my experience, the primary factor to which [the applicant] has regard in deciding whether to participate is whether it can physically perform the requested services in a manner consistent with proper clinical practice. Further, in my experience, [the applicant] does not decline requests because the contracted rates, as agreed with the third party by [Research International or Research US], are not agreeable to [the applicant].*
>
> *If [the applicant] is capable of performing the requested services, [the applicant] notifies the [Global PM] via email that it is able to perform the requested services.*
>
> *[The applicant] then performs the requested services in accordance with the*

terms of the [Group Master Agreement] and the request.
In my experience, once [the applicant] accepts a request to carry out a clinical trial, the sole focus of [the applicant's] activities is the achievement of the desired clinical objective – for example, the generation of new knowledge regarding the safety and efficacy of a drug.
...
When [the applicant] conducts trials, it does so in accordance with the Guideline for Good Clinical Practice (GCP) prepared by the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use Guidelines (ICH) ... The ICH is a body comprised of representatives of regulatory authorities and the pharmaceutical industry. One of its purposes is to promulgate harmonised technical requirements to ensure that clinical research is conducted rigorously and in accordance with the principles of established science. In my experience, the GCP operates as an international ethical and scientific quality standard for designing, conducting, recording and reporting trials that involve the participation of human subjects. Australia's National Health and Medical Research Council has adopted the principles of the GCP in its National Statement on Ethical Conduct in Human Research ... In my experience, employees of [the applicant] who are involved in clinical trials are familiar with the contents of the GCP, retain a copy of the GCP in their possession during the course of trials and attempt to ensure that the trials are conducted in accordance with the GCP.

THE AGREEMENTS WITH PHARMA CORPORATION

13. Over a period of time, two companies in the Research Group, first Research UK and later Research US, entered into agreements (the **Services Master Agreements**) with an international pharmaceutical company (**Pharma Corporation**) for the provision of clinical research management and related services. Both of these Services Master Agreements were evidently intended to prescribe the broad framework within which the Research Group would provide relevant services to the Pharma Group.
14. The particular services to be provided by the Research Group from time to time would be specified in individual **Task Orders** agreed between a Pharma Group member and a Research Group member, generally Research UK or Research US. The relevant Research Group member would become the Contract Holder for the purposes of the Group Master Agreement.
15. The Services Master Agreements also provided that:
    (a) the relevant Research Group member would submit to Pharma Corporation a detailed annual budget of anticipated expenses by reference to specified sub-activities. If Pharma approved the budget, then it would pay for the services accordingly, and in accordance with an agreed payment schedule;
    (b) Pharma Corporation and its related entities would own the intellectual property produced as a direct result of the services being performed; and
    (c) "corporate affiliates" of the relevant Research Group member might perform some of the services to be provided under the Services Master Agreements and any Task Orders.

THE ACTIVITY IN QUESTION

16. Between 2011 and 2013, various entities in the Research Group carried out a clinical trial (the **Global Project**) for Pharma Corporation. That project involved testing the safety and efficacy of a drug (the **Test Drug**) which is aimed at treating a particular **Illness**. The applicant participated in four protocols, or studies, under the Global Project.
17. One of the studies in which the applicant participated was **Sub-Project 6**. Earlier studies under the Global Project had examined the safety and efficacy of lower doses of the Test Drug, sometimes in combination with other treatments.
18. Sub-Project 6 began in late 2011 when a **Start-up Task Order** was agreed between certain

members of the Pharma Group and Research US. Under the Start-up Task Order, Research US contracted to perform preliminary start-up services in connection with the study, identified by name and described as:

> *A Multicenter ... Study to Evaluate Outcomes of [a higher dosage of the Test Drug in subjects who have the Illness and who also have other specified medical conditions].*

19. Sub-Project 6 was what is known in the clinical research industry as a Phase III trial. Ms Collins explained:

> *Phase III trials involve double-blind studies with placebo or comparator treatment controls and are conducted on larger populations, [who] suffer from the targeted disease or condition. In the double-blind studies, one group of patients is given the drug while another group receive an inert substance or comparative standard treatment. [The applicant] does not inform either the doctor or patient as to which group of patients is given the tested drug.*

20. Once the preliminary work in response to the Start-up Task Order was complete, a subsequent Task Order for the substantive study was agreed between Pharma US and Research US. The Task Order is expressed to be subject to and to be governed by the second of the Services Master Agreements referred to in [13] above. Attached to and forming part of the Task Order were tables setting out the Scope of Work, Project Budget, Timeline and Payment Schedule. The Task Order was supplemented by a Change Order agreed between the contracting parties later in 2012, but nothing turns on the content of the Change Order.
21. The study was to be conducted in various territories including Australia. The applicant would be the entity carrying out the study in Australia.
22. The Protocol for Sub-Project 6[3] proposed a study to be conducted in about 700 sites globally, and involving about 5000 subjects. The duration of the study would be dependent on the number of major adverse outcomes but was expected to be about six years. The primary objective of the study was to demonstrate the safety and efficacy of the Test Drug in the particular trial conditions. It is the actual testing of the safety and efficacy of the Test Drug that the applicant claims is a core R&D activity.
23. The Protocol notes that some clinical data already existed for the Test Drug. That data is contained in the Investigator Brochures produced by the Pharma Group and referred to by Ms Collins in her affidavit[4]. Those Investigator Brochures provide extensive information about the studies undertaken to date, on both animal and human subjects. The study would seek to add to that data by confining the study to participants with particular additional medical conditions, testing the participants' reaction to the higher doses of the Test Drug and by comparing side-effects, if any, with those known to exist with alternative treatments.
24. The Protocol is a very comprehensive document covering topics including Study Objectives; Study Design and Description; Selection and Discontinuation/Withdrawal of Subjects; Clinical Trial Material Management; Study Plan; Data Handling and Recordkeeping; Statistical Methods; and Ethical Aspects of the Study.
25. Documents described as Operations Plans (**OPs**)[5] were then created within the Research Group for the Global Project. The expressed purpose of the OPs was:
    1. *To establish and document the practical working methods for the clinical team based upon the protocol, scope of work, and contract in order to ensure the effective and efficient provision of data required to assess the principal aims of this study in [the Illness].*
    2. *To facilitate the exchange and documentation of relevant information and expectations between [Research Group] and [Pharma Group].*
26. There is also a Quality Management Plan (**QMP**), a Communication Plan (**CP**) and a Clinical Training Plan (**CTP**) for the Global Project, and a Project Plan for Sub-Project 6.

27. The QMP details how the applicant will achieve, execute, control and ensure quality standards for the Global Project. The CP sets out communication tools, team roles and responsibilities, how the applicant will communicate with the client and how the applicant will communicate with the various sites where the trial is being undertaken. The CTP sets out details of how the applicant's employees will be trained to allow them to conduct the clinical research in a manner that is consistent with established scientific principles.
28. The Project Plan sets out the phases and timelines for completion of the activities to be conducted under Sub-Project 6. The phases involve the determination of the question posed by the Protocol, through the undertaking of steps consistent with scientific methodology in a scientifically rigorous way. The steps include screening of subjects, randomisation, evaluation of subjects, and data gathering and analysis.
29. Owing to concerns relating to adverse pathology in some of the study participants, the study was terminated in 2013.

DOES THE ACTIVITY ANSWER THE STATUTORY DESCRIPTION?

30. Ms Collins said that documents such as the Protocol, the various OPs, and the QMP, and the Research Group's compliance with them, are essential to ensuring that the kinds of research conducted by the applicant are conducted "rigorously, systematically and in accordance with the principles of established science". Ms Collins also expressed a belief that the activity carried out by the applicant in relation to the study was conducted in a manner that was generally consistent with the various documents just referred to.
31. Ms Collins also said that, based on her experience, she would characterise an activity carried out in accordance with those documents as "experimental". She thought that an activity carried out in that way:

    (d) would consist of what, in the area of science and in ordinary language, would be called an "experiment" or "experiments";
    (e) would involve the testing of a theory: in particular, the theory stated in the Primary Objectives section of the Protocol (summarised in [19] above);
    (f) would involve an attempt at something original, namely the testing of the specified higher dosage of the Test Drug in the specified circumstances; and
    (g) would involve the trying out of a new technique, namely the use of that higher dosage of the Test Drug as a treatment.
32. I find that Activity 1 is experimental activity, in that it constituted a test or trial; it was an act or operation for the purpose of discovering something unknown or testing a principle, supposition, etc: *Macquarie Dictionary*, definition of "experiment".
33. Moreover, on the basis of Ms Collins' evidence as set out in [12] and [30]-[31] of these reasons, I find that Activity 1 meets all the elements of paragraph (a) of the definition of "core R&D activities", in that:
    - the outcome of the activity could not be known or determined in advance on the basis of the knowledge, information or experience that was current at the time they were conducted, since the specified dosage had not previously been tested in the specified circumstances on subjects in the specified category; and
    - the outcome of the activity could only be determined by applying a systematic progression of work based on principles of established science and proceeding from hypothesis to experiment, observation and evaluation, and leading to logical conclusions. That is the essence of clinical drug trials, and the only reliable way that additional knowledge can be obtained.
34. The real contest between the parties is in relation to paragraph (b) – namely, whether Activity 1 was conducted for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services).

PURPOSE

35. The applicant submits that the activity meets the requirements of paragraph (b) because it was *conducted for the purpose of generating new knowledge*. The respondent disagrees, saying that

the applicant did not hold that purpose when it conducted the activity, or alternatively that if it did hold that purpose, it did not do so to the requisite degree.

36. In the internal review decision (which is the decision currently under review) the respondent reasoned in relation to Activity 1 as follows[6]:

> *The Company has not demonstrated that the applicant, nor any relevantly associated foreign entity, had the purpose of generating new knowledge (in any form) in relation to undertaking Activity 1 as required by paragraph 355-25(1)(b) of the Income Tax Assessment Act 1997.*
> *The only significant purpose for [the applicant] and its foreign relation, [Research US], for undertaking Activity 1 was to perform specific services to fulfil their contractual obligations. As those entities hold no rights to the drug being tested, any interest those Companies may have had in the results can only be incidental.*
> ...

37. Essentially that remains the respondent's position.

THE RESPONDENT'S SUBMISSIONS

38. There are two central propositions that the respondent makes in relation to "purpose" in s 355-25(1)(b). The *first* of those propositions is that the requisite purpose must be held by the applicant R&D entity. The *second* is that the applicant R&D entity must conduct the activities for at least the dominant purpose of generating new knowledge, and the presence of this purpose must be necessary to its conduct of the activities.

The respondent's first proposition – the purpose must be held by the applicant R&D entity

39. The *first* proposition is based on a consideration of the context of the IRD Act, the objects of the relevant parts of the Act, and the interaction between those parts of the Act and relevant provisions in the ITAA 1997.
40. The respondent notes that the objects of Part III of the IRD Act (where the power to make advance findings resides) are set out in s 26 as follows:

> *(a) to provide integrity for the working out of tax offsets under Division 355 (about R&D) of the Income Tax Assessment Act 1997; and*
> *(b) to increase certainty through findings about matters relevant to the working out of those tax offsets; and*
> *(c) to improve access for small and medium R&D entities to quality research services by maintaining a register of research service providers.*

41. Complementary to those objects is the object of Division 355 of the ITAA 1997, set out in s 355-5 of that Act:

> *(1) The object of this Division is to encourage industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian community.*
> *(2) This object is to be achieved by providing a tax incentive for industry to conduct, in a scientific way, experimental activities for the purpose of generating new knowledge or information in either a general or applied form (including new knowledge in the form of new or improved materials, products, devices, processes or services).*

42. The respondent submits that the object in s 355-5 of the ITAA 1997 must be pursued in a way that is consistent with the IRD Act, given the object in s 26(b) of the latter Act, of increasing certainty through findings made by the respondent with regard to tax offsets[7].
43. It then submits[8]:

> *The purpose of making an advance finding is to bind the Commissioner as to that finding in order to secure certainty for the R&D entity. It is not part of*

Innovation Australia's function under s 28A to make a finding as to eligibility of expenditure under Sub-divisions 355-D or 355-F. An advance finding cannot bind the Commissioner on that issue. ***However, there is little practical point in making an advance finding if the expenditure of the R&D entity is excluded by the eligible expenditure provisions. The object in s 26(b) of the IRD Act would not be promoted by binding the Commissioner to accept that an "activity" is an "R&D activity", when it is clear that the activity does not meet the "conditions for R&D activities" set out in s 355-210*** ... (emphasis added)

44. The written submissions continue:

[2.12] The objects section [s 355-5 of the ITAA 1997 – see [41] of these reasons] refers generally to encouraging "industry" rather than "R&D entities". The concern is to give an incentive to industry to engage in R&D activities that might not be conducted because of an uncertain return. The encouragement is to be given in cases where the knowledge gained is likely to benefit the wider Australian community. The incentive is available to an industry participant that has a choice as to whether or not it conducts the activities. If there were no choice about it, an incentive could not operate to influence choice. ***An assumption inherent in the objects section is that R&D is not the sole activity of the industry participant. Research and development is an activity that is additional, that might not be entertained, that might not give a return, and that might be forgone. Another assumption made in the objects section is that there is a possibility of a commercial return for the activities, but not a certain one.***
[2.13] This is not a description of the position of an entity that is wholly engaged in conducting R&D, whether for one or more principles or contractors. In the case of such an entity the tax offset cannot operate as an incentive to engage in R&D activities that might not otherwise be undertaken. The activities are undertaken because that is the commercial enterprise in which the entity is engaged.
...
[2.28] As discussed in paragraph 2.9 above, it is not for Innovation Australia to make a finding as to eligible expenditure. ***However in determining the question as to who is to hold "the purpose" referred to in s 355-25(1)(b), it is relevant to take account of the conditions for R&D activities.*** *Where activities are conducted in Australia for a foreign resident that is connected, or an affiliate, under a binding contract, the expenditure does not attract the tax offset. This is a condition that is intended to promote two objects in s 355-5(1). Firstly, the tax offset is directed to providing an incentive to industry to conduct R&D activities that might not otherwise be conducted because of an uncertain return [on] those activities. Where activities constitute services performed under contract for a fee, the services will be performed in any event pursuant to that contract. The return is not uncertain and the tax offset does not affect the decision whether or not to perform the services. Secondly, the incentive is intended to generate new knowledge that is likely to benefit the wider Australian community. In denying eligibility for expenditure incurred in the performance of a contract for a foreign entity, Sub-division 355-D proceeds on the premise that the performance of contractual obligations by an R&D entity in Australia for a foreign entity does not promote the object of generating new knowledge that is likely to benefit the Australian community.*
...
[2.40] Consideration of the context of the IRD Act and the context of Division 355 of the ITAA 1997, in particular Sub-divisions 355-D and F,

with the objects in s 355-10, indicates that "the purpose" in s 355-25(1)(b) must be held by the R&D entity that applied for the advance finding.
(emphasis added)

The respondent's second proposition – the purpose must be at least the dominant purpose

45. In support of the *second* proposition, the respondent relies on the text of s 355-25 of the ITAA 1997 and the broader context of the IRD Act and Division 355 of the ITAA 1997. It also calls in aid the explanatory memorandum to the *Tax Laws Amendment (Research and Development) Bill 2010*, and the way the expression "the purpose" has been interpreted in other statutory contexts.
46. The respondent reaches its ultimate submission despite the close juxtaposition of the expression "the purpose" in s 355-25(1)(b) with the expression "the dominant purpose" in s 355-25(2)(h) and s 355-30(2) – a circumstance that, at first glance, may suggest that "the purpose" might be intended to mean something other than "the dominant purpose". It maintains its view after a careful consideration of the provisions as a whole, and of various authorities decided under the predecessor legislation, s 73B of the *Income Tax Assessment Act 1936* (the **ITAA 1936**)[9].
47. The respondent also submits that a test of at least the dominant purpose is consistent with the objects in s 355-5 of the ITAA 1997. At [3.25] the respondent submits:

> *The objects in s 355-5 must be understood by reference to the provisions of Division 355 as a whole, including Subdivisions 355-D and F. Where the purpose is to conduct activities for a foreign resident that is associated, or an affiliate, in accordance with a binding contract, or to conduct activities for consideration, the tax offset is not attracted. This promotes the object in s 355-5(1). Consistently with the provisions of Subdivisions 355-D and F and s 355-5, a purpose of generating new knowledge needs to be at least the dominant purpose by comparison with some concurrent purpose of performing a contract for a foreign resident or obtaining consideration. This is not just a matter of its being pointless for an activity to pass the purpose test of s 355-25(1)(b) when, on account of those very purposes held by the R&D entity, the associated expenditure could not possibly pass the requirements of Subdivisions 355-D or 355-F. It is a matter of construing "the purpose" in s 355-25(1)(b) in a way that is consistent with the objects and the other provisions of Division 355.*

THE APPLICANT'S SUBMISSIONS

48. The applicant's submissions in relation to s 355-25(1)(b) of the ITAA 1997 are perhaps best summarised by the following words in its Outline of Submissions, at [41]:

> *[T]he 1997 Act means what it says and no more.*

49. In its Outline of Submissions in Reply, it submits that the respondent's proposed construction rests on a number of propositions, most of which, according to the applicant, rely on a "reading down" of s 355-25(1)(b), including:
    - that where expenditure on an activity is not eligible for offset because of provisions subsequent to s 355-25, the activity itself is not treated as a core R&D activity;
    - that an activity is only treated as being conducted for the purpose of generating new knowledge if the person conducting the activity has an uncertain financial return from the activity;
    - that an activity is only treated as being conducted for the purpose of generating new knowledge if the person conducting the activity is not conducting the activity for or for the benefit of a foreign resident;
    - that an activity is only treated as being conducted for the purpose of generating new

knowledge if the person is not carrying on "business as usual" by conducting the activity;
    - that s 355-25(1)(b) should be read down in light of the IRD Act;
    - that the test in s 355-25(1)(b) is a "but for" test, or one requiring that the purpose of generating new knowledge is a "necessary" purpose.

50. The applicant says simply this: s 355-25 is a definitional provision; whether an activity is within the definition is a question of characterisation; there is no gap that needs to be filled with notions of dominant purpose, or significant purpose, or but-for purpose; and if the activity is within the definition, one then turns to the "operational" provisions in the remainder of Division 355 to see whether tax offsets are available.

CONSIDERATION

51. I agree with the respondent's submission that for s 355-25(1)(b) to be engaged, the relevant purpose must be held by the applicant R&D entity. Contrary to the respondent's submission, though, the applicant did not avoid confronting that issue. Ms Collins' affidavit was plainly targeted at identifying the purpose or purposes for which Activity 1 was conducted by the applicant.
52. However, I do not agree with the respondent's submission that an entity only holds "the purpose" referred to in s 355-25(1)(b) if the entity holds that purpose as the dominant or prevailing purpose. Clearly, it is not enough that the entity *merely* holds the purpose as one of many; the provision would probably have to refer to "a" purpose rather than "the" purpose for that to be the case. But the purpose of generating new knowledge does not have to be the purpose that outweighs all the others. Instead, I consider that the purpose of generating new knowledge must be more than an insubstantial purpose; it must be substantial enough to enable the activity to be accurately characterised as conducted for that purpose. That will sometimes involve questions of degree which may be difficult to resolve. Nevertheless, it needs to be recognised that the purpose of generating new knowledge may be a substantial purpose even if at the same time other substantial purposes also exist. And the fact that an alternative purpose for the activity may be identified as a substantial purpose does not necessarily lead to a conclusion that the purpose of generating new knowledge may not also be identified in that way.
53. In the case under consideration here, I find that one of the substantial purposes for which the activity was conducted was to generate new knowledge. I make that finding on the basis of Ms Collins' evidence, which is entirely consistent with the documentation surrounding Sub-Project 6 as referred to above. In making that finding I do not ignore the fact that any new knowledge that was generated through the conduct of the activity would immediately be sent to a Research Group company in India for analysis. That arrangement necessarily resulted in the applicant's never having the use of any new knowledge generated, but I consider that outcome irrelevant to the enquiry.
54. More broadly, and for the purpose of dealing with the respondent's comprehensive submissions relating to the statutory construction questions arising in this case, I provide the following guidance.
55. The respondent is charged, under s 28A of the IRD Act, with the responsibility of finding whether a particular activity is, or is not, a core R&D activity. To fulfil that responsibility it must consider the definition of "core R&D activities" in s 355-25(1) of the ITAA 1997. A finding under s 28A is a finding about an *activity*; it is not a finding about whether tax offsets are or are not available.
56. There is no occasion for the respondent, in considering whether an activity is or is not within the definition, to take into account any of the matters in the remainder of Division 355 of the ITAA 1997 that bear on whether tax offsets are available to the entity requesting an advance finding about an activity. In my view, there is a clear demarcation between the "definitional" and the "operational" provisions in Division 355, as identified by the applicant. The drafting is entirely orthodox. First, are the activities within the definition? Second, does expenditure attract the tax offset?
57. When the respondent submits, as it does in [2.9] of its written submissions[10], that "there is

little practical point in making an advance finding if the expenditure of the R&D entity is excluded by the eligible expenditure provisions", it engages in overreach. That is because the question whether expenditure is excluded by the eligible expenditure provisions is a question for the Commissioner of Taxation, not the respondent. Whether an entity's expenditure is, or might be, excluded by those provisions has no role to play in the assessment of whether the target activities are "core R&D activities".

58. The respondent is also wrong, in my view, to submit (as it does, again at [2.9] of its written submissions) that the object of s 26(b) of the IRD Act "would not be promoted by binding the Commissioner to accept that an 'activity' is an 'R&D activity', when it is clear that the activity does not meet the 'conditions for R&D activities' set out in s 355-210". This is because the "certainty" of which s 26(b) speaks is the certainty *about the status of the activity as a core R&D activity* within the definition. That is the area where the certainty is required. Armed with the certainty of such a finding (if it is favourable), the entity can then approach the Commissioner to decide the related, but different, question as to whether tax offsets are available.
59. One of the other objects of Part III of the IRD Act, expressed in s 26(a), is to "provide integrity for the working out of tax offsets under Division 355 ...". The respondent notes that the paragraph refers to the whole of Division 355, not just to that part of the Division that defines core and supporting R&D activities. That is true, but it does not assist the respondent's argument. The "integrity" to which the paragraph refers is the integrity achieved by the systematic, consistent consideration of the activities presented to it by entities seeking advance findings. The respondent is a specialist body, well equipped for that task.

CONCLUSION

60. Since both paragraphs (a) and (b) of s 355-25(1) of the ITAA 1997 are satisfied with respect to Activity 1, that activity is a "core R&D activity".
61. Because the respondent initially found that Activity 1 was not a "core R&D activity", it was bound to find that Activities 3 and 5 were not "supporting R&D activities". Activity 3 is described in the original application[11] as "Recruitment" and Activity 5 as "Site close out activities". On the face of it those activities appear to be within the definition of "supporting R&D activities" in s 355-30(1) of the ITAA 1997 – "activities directly related to core R&D activities". Furthermore, on the face of it they would not appear to be excluded by subsection (2). However, because there is scant information before me as to the precise scope of Activities 3 and 5, it would be inappropriate for me to make a formal finding that they are supporting R&D activities as defined. The better course is to remit that question to the respondent for reconsideration in light of my finding that Activity 1 is a "core R&D activity".
62. I will hear the parties on whether the application should now be disposed of, in accordance with my findings and reasons, under s 43 of the Administrative Appeals Tribunal Act 1975 or whether a more appropriate course is to remit the matter to the respondent for reconsideration under s 42D of that Act. A directions hearing for that purpose will be listed at the earliest opportunity.

[NOTE TO ANNEXURE A: Paragraphs 61 and 62 have now been superseded – see paragraphs 4 and 5 of the 'Background'.]

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[1] s 1-7 of the ITAA 1997

[2] Not her real name

[3] Exhibit A1, Tab 34

[4] Exhibit A1, Tabs 44 to 46

[5] Exhibit A1, Tabs 35 to 39

[6] T1-7

[7] Respondent's Outline of Submissions, at [2.9]

[8] ibid

[9] Respondent's Outline of Submissions, at [3.2]-[3.24]

[10] See [43] above

[11] T26-198
