

1988

PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

RESEARCH AND DEVELOPMENT LEGISLATION AMENDMENT BILL 1988

EXPLANATORY MEMORANDUM

(Circulated by the authority of Senator the Honourable
John N Button, Minister for Industry, Technology and Commerce).

RESEARCH AND DEVELOPMENT LEGISLATION AMENDMENT BILL 1988

OUTLINE

1 The purpose of this Bill is to amend the Income Tax Assessment Act 1936 and the Industry Research and Development Act 1986 to increase the effectiveness of the 150% tax concession in stimulating investment in research and development (R&D) by industry in Australia and ensure that Australia obtains a proper return on revenue-subsidised R&D.

2 The Bill will increase the efficiency of administration of the concession by transferring to the IR&D Act those powers and functions of the Industry Research and Development Board (the Board) which are at present provided for in the Income Tax Assessment Act.

3 This Bill will implement a number of the proposals announced by the Treasurer and the Minister for Industry, Technology and Commerce on 20 November 1987.

4 To reduce the incidence of companies being required to reimburse tax benefits subsequent to a tax audit, the Bill empowers the Board to refuse to register a company if the activities cited in the application for registration are not R&D activities or for such other specified reasons as may be within the Board's authority to determine.

5 The Board's powers are to be broadened so as to ensure that large claims may not be made for projects which have an insufficient Australian content. The Bill also tightens up existing provisions which are designed to enable the Board to cause the loss of tax benefits where a company fails, in any significant way, to exploit the results of revenue subsidised R&D on normal commercial terms and to the benefit of the Australian economy.

6 The circumstances in which access to the tax concession is available for contracted expenditure incurred by companies whose annual R&D expenditure is less than \$50 000 will be extended. For the purposes of the tax concession, the Bill establishes a new category of research body, the Registered Research Agency (RRA) to replace Approved Research Institutes. RRAs will be registered by the Board and will not be limited to non-profit organisations.

7 To encourage investment in projects of R&D which are too big or too risky to be advanced solely by those with the ability to directly use the results, the Bill will enable the Board to provide prior "in principle" approval and subsequently to jointly register participating companies. Companies registered in this manner will be assured of their entitlements to the tax concession unless they depart from the terms of the venture as approved.

FINANCIAL IMPACT

8 To the extent that the amendments are successful in stimulating R&D which would not otherwise have been undertaken during the deduction period (ie prior to 30 June 1991), there will be some additional tax revenue loss in the fiscal year 1988/89 and the three following years. There will be offsetting savings due to the tightening up of provisions to limit avenues by which the 150% tax concession may be exploited otherwise than as intended.

ABBREVIATIONS

9 The following abbreviations are used in this explanatory memorandum:

Board : Industry Research and Development Board
 ITAA : Income Tax Assessment Act 1936
 IR&D Act : Industry Research and Development Act 1986

NOTES ON CLAUSES

PART I - PRELIMINARY

Clause 1 : Short title

10 This clause provides for the Act to be cited as the Research and Development Legislation Amendment Act 1988.

Clause 2 : Commencement

11 This clause provides for the Act to come into operation on 1 July 1988.

PART II - AMENDMENTS OF THE INCOME TAX ASSESSMENT ACT 1936

Clause 3 : Principal Act

12 This clause provides that in this Part a reference to the "Principal Act" is a reference to the Income Tax Assessment Act 1936 ("ITAA").

Clause 4 : Officers to observe secrecy

13 This clause widens the power of the Commissioner of Taxation to disclose to the Australian Statistician information in relation to research and development. At present disclosure

may be made only for the purposes of periodic surveys of industries or the compilation of the national accounts. The clause will allow the disclosure of information required in connection with the conduct of periodic surveys of research and development activities.

14 Paragraph 16(4)(ga) of the ITAA permits disclosure of information for certain purposes of the Census and Statistics Act 1905. The proposed sub-subparagraph 16(4)(ga)(ii)(BA) will authorise the Commissioner to provide information to the Australian Statistician for or in connection with the conduct of periodic surveys of research and development activities.

15 Paragraph 4(b) of the Bill will complement the insertion of the new sub-subparagraph 16(4)(ga)(ii)(BA) by inserting a definition of "research and development activities", a term used in the new sub-subparagraph. Research and development activities will have the same meaning as in section 73B of the ITAA.

Clause 5 : Expenditure on research and development activities

16 The clause proposes several amendments of section 73B of the ITAA which authorises accelerated write-off of expenditure incurred in respect of research and development activities.

17 Paragraph 5(a) proposes the omission of the present definition of "contracted expenditure" and the insertion of a new definition which takes into account the withdrawal of the special status of approved research institutes (as defined in subsection 73B(1) of the ITAA) from 30 June 1988 and the transfer of that special status to research associations which will be registered under proposed section 39F of the Industry Research and Development Act 1986 IR&D Act (see notes on clause 15).

18 Under subsection 73B(13) of the ITAA, where an eligible company incurs certain contracted expenditure during a year of income, an amount equal to 150% of that for income tax purposes expenditure is deductible whether or not the company has met the threshold requirements of section 73B.

19 The new definition of "contracted expenditure" will relate to expenditure incurred by an eligible company :

- (a) during the period from 1 July 1985 to 30 June 1991 (the "deduction period") - to the Coal Research Trust Account (established under section 4 of the Coal Research Assistance Act 1977) in consideration for that Trust Account funding the performance, during that period, of research and development activities on behalf of the company;
- (b) during the period from 1 July 1985 to 30 June 1988 - to an approved research institute in consideration for that institute performing, during that period, research and development activities on the company's behalf; and
- (c) during the period from 20 November 1987 to 30 June 1991 - to a body (not being an associate of the eligible company) that was, or is taken to have been, registered under proposed section 39F of the IR&D Act (see notes on clause 15) in consideration for that body performing, during that period, research and development activities of the class of specified activities in respect of which the body is registered as a research agency.

"Associate" is, under a definition inserted in subsection 73B(1) by Taxation Laws Amendment Bill (No.5) 1987, given the same meaning as in section 26AAB of the ITAA. The definition in section 26AAB specifies who is an associate in relation to a natural person, a company, a trustee of a trust estate or a partnership and, in broad terms, refers to those persons who by reason of family or business connections might appropriately be regarded as being associated with a particular eligible company.

20 Paragraph 5(b) of the Bill proposes the insertion of a new subsections 73B(1B) which will limit the circumstances in which expenditure will be treated as "contracted expenditure" (see notes above re paragraph 5(a)). Expenditure incurred to a body which is a research agency referred to in paragraph (c) of the definition of "contracted expenditure" will not be treated as contracted expenditure unless, when the expenditure was incurred, the eligible company incurring the expenditure was capable of utilising, or had formulated a plan to utilise, any results of the research and development activities directly in connection with its business or a business that it proposed to carry on.

21 Paragraphs (c) and (d) of clause 5 effect in part the transfer of legislative authority for the registration of companies - registration being a precondition for eligibility for deductions under section 73B - from that section to the IR&D Act (the residual steps in the transfer of authority is effected under clause 15 - see notes on proposed new sections 39J and 39P of that Act).

22 The amendment made to subsection 73B(10) of the ITAA by paragraph 5(c) will delete the reference to the present registration provision - subsection (12) which is being repealed by paragraph 5(d) - and replace it with a reference to the new registration provisions - proposed sections 39J (individual registration) and 39P (joint registration) - to be inserted by clause 15 in the IR & D Act.

23 Subsections 73B(11) and (12) of the ITAA contain the present provisions relating to registration of companies for the purposes of eligibility for deductions under that section. As legislative authority for the registration of companies is to be relocated in proposed sections 39J and 39P of the IR&D Act, subsections (11) and (12) are to be repealed by paragraph 5(d).

24 Under subsection 73B(33) of the ITAA, if the Industry Research and Development Board ("the Board") is of the opinion that any of the results of research and development activities, in respect of which expenditure has been deductible under section 73B, have not been exploited on normal commercial terms, and for the benefit of the Australian economy, the Board may issue a certificate which has the effect of deeming that expenditure never to have been deductible under section 73B.

25 For the purposes of making an income tax assessment, the Commissioner of Taxation is empowered under subsection 73B(34) of the ITTA to seek a determination from the Board as to whether particular activities are research and development activities. The Board is required to comply with that request and, under subsection 73B(35), its determination of the matter is binding on the Commissioner.

26 In the light of the expansion of the Board's functions and responsibilities under the amendments made by Part III of the Bill the power to issue certificates requiring disallowance of deductions is also to be vested in the Board under the IR&D Act. As a result, subsections 73B(33), (34) and (35) are to be omitted and replaced by new subsections which reflect the addition of such certificates.

27 New subsection 73(B)(33), to be inserted into the ITAA, will be subject to new subsection (33C) (see below) and relates to the certificates issuable by the Board under proposed section 39M of the IR&D Act (see notes to clause 15). Proposed section 39M has a similar function to that contained in the present subsection 73B(33) of the ITAA and will allow the Board to issue a certificate if it is of the opinion that the results of the research and development have been exploited otherwise than on normal commercial terms or for the benefit of the Australian economy. In addition, proposed section 39M will allow the Board to issue a certificate if the research and development activities do not have an adequate Australian content (see notes to proposed section 39E of the IR&D Act).

28 Where a certificate has been issued by the Board under proposed section 39M of the IR&D Act in respect of particular activities in respect of which expenditure has been incurred by a company, a deduction under section 73B is not allowable and is deemed never to have been allowable for that expenditure in respect of those activities.

29 New subsection 73B(33A), to be inserted into the ITAA by paragraph 5(e), is subject to new subsection (33C) and relates to certificates issued under proposed section 39N of the IR&D Act (see clause 15) for failure to comply with a notice issued under that section by the Board. Where a company fails to comply with such a notice, income tax deductions in relation to expenditure upon the activities in respect of which the notice was issued will not be allowable, and will be deemed never to have been allowable, under section 73B.

30 It is proposed, under new section 39P of the IR&D Act (being inserted by clause 15 of the Bill), that the Board be permitted to register two or more companies jointly for the purposes of eligibility for income tax deductions under section 73B of the ITAA. If the Board becomes of the opinion that any of the following circumstances mentioned in subsection 39P(4) of the IR&D Act exist -

- (a) any of the money paid by the companies has not been spent on research and development activities;
- (b) any of the results have not been appropriately exploited;
- (c) the activities do not have an adequate Australian content;
or
- (d) any of the companies has assigned its rights in respect of the exploitation of the results of the research and development before the project is completed;

the Board must advise the company or companies of its intention to issue a certificate under that subsection. Where the Board proceeds to issue that certificate, proposed subsection 73B(33B) of the ITAA applies to deny deductions under section 73B in respect of expenditure incurred by that company or companies after the date of the Board's advice (given under paragraph 39P(5)(a) of the IR&D Act) of its intention.

31 Proposed subsection 73B(33C) of the ITAA will allow the effect of new subsections (33), (33A) or (33B) to be reversed where a certificate issued by the Board under new sections 39M, 39N, or 39P of the IR&D Act is subsequently revoked. Where such a revocation occurs, the certificate will be deemed never to have been given.

32 New subsection 73B(34) of the ITAA is to have the same effect as the present subsection 73B(35) in that a certificate of the Board stating whether particular activities were research and development activities is binding upon the Commissioner of Taxation. Under new section 39L of the IR&D Act the Board is to provide the Commissioner with such a determination if requested by the Commissioner.

Clause 6 : Amendment of assessments

33 This clause will amend subsection (10) of section 170 of the ITAA, which allows the Commissioner of Taxation to re-open income tax assessments at any time in certain cases, without the limitations usually applying to the making of amended assessments, where this is necessary to give effect to specified provisions of the ITAA. Clause 6 of the Bill will extend the special amendment provisions to include references to the new subsections 73B(33), (33A) and (33C). This will ensure that the Commissioner will have the necessary authority to give effect to those provisions which are discussed in the notes on clause 5.

Clause 7 . Application

34 The amendments made by Part II of the Bill will, by clause 7, which does not amend the ITAA, apply to assessments made after the commencement of this Act in respect of any year of income.

PART III - AMENDMENTS OF THE INDUSTRY RESEARCH AND DEVELOPMENT ACT 1986Clause 8 : Principal Act

35 This clause provides that in this Part a reference to the "Principal Act" is a reference to the Industry Research and Development Act 1986 ("IR&D Act").

Clause 9 : Amendment of title

36 This clause widens the title of the IR&D Act as a consequence of the inclusion in the Act of the provisions conferring powers on the Industry Research and Development Board ("Board") for the purposes of the income tax concessions.

Clause 10 : Object of Act

37 This clause makes a similar consequential amendment of the section of the IR&D Act that sets out the object of that Act.

Clause 11 : Constitution of Board

38 This amendment increases the number of Board members from 10 to 13. This increase will enable the Board to carry out the additional functions imposed on it since its inception in 1986, including those included in this Bill.

Clause 12 : Delegation by Board

39 This amendment is included to enable the Board to more efficiently carry out its functions by empowering the Board to delegate its powers to a committee of the Board appointed by the Minister under section 22 of the IR&D Act. Currently the Board may delegate its powers to a Board member or a member of the staff assisting the Board only.

Clause 13 : Committees

40 This amendment enables a committee to exercise a power delegated to it by the Board. The only power a committee currently has is to provide advice to the Board. Accordingly exercise of a power delegated to it may otherwise be construed as ultra vires.

Clause 14 : Delegation by committee

41 This clause inserts a new provision in the IR&D Act enabling a committee of the Board to delegate any of its powers to a member of the committee or a member of the staff assisting the committee, including powers delegated to it by the Board.

Clause 15 : Eligible companies

42 This clause makes an amendment that is consequential upon the inclusion in the IR&D Act of the Board's new powers. It provides that the Board's powers to declare a company to be an eligible company for the purposes of grants under the present IR&D Act will not apply to the Board's functions under the proposed Part IIIA, that is its functions for the purposes of the Income Tax Assessment Act. The expression "eligible company" has a more restrictive scope for the purposes of the income tax concessions.

Clause 16 : New Part IIIA

43 This clause inserts a new Part IIIA in the Industry Research and Development Act relating to the functions of the Board concerning income tax concessions, as follows:

Section 39A : Interpretation

- (a) Proposed section 39A defines various expressions that are used in the Part so that those expressions are consistent with the same expressions as used in the provisions of the Income Tax Assessment Act relating to the concessions for expenditure on research and development. Other definitions are included for technical drafting reasons.

Section 39B : Related companies

- (b) Proposed section 39B provides that the meaning to be given to the expression "related companies" in the Part is to be the same as the meaning given by the Companies Act. The expression is used in proposed paragraph 39P(3)(b).

Section 39C : Exploitation otherwise than on normal commercial terms

- (c) Proposed section 39C defines the expression "exploitation otherwise than on normal commercial terms". The expression applies to the situation where the terms of a contract or transaction are different from those that would have been included if the parties had been dealing at arm's length and from provisions of comparable bargaining power. This provision will prevent the loss of the return that should result from successful research and development. The taxation consequence of exploitation of an activity otherwise than on normal commercial terms is set out in proposed section 39N of the IR&D Act and clause 5 of this Bill (proposed subsection 73B(33) of the ITAA).

Section 39D : Exploitation otherwise than for the benefit of the Australian economy

- (d) Proposed section 39D explains what is meant by the expression "exploitation otherwise than for the benefit of the Australian economy". The provision is designed to prevent companies obtaining the tax concessions and then failing to exploit the results for the benefit of the Australian economy. The expression applies to the case where the profits or gains to Australian residents from the exploitation of the results of research and development activities are, in a significant aspect, not commensurate with the expenditure incurred in Australia on the activities. The proposed section sets out matters to which the Board is to have regard to in forming an opinion on an activity for the purposes of the section. The taxation consequence of exploitation of an activity otherwise than for the benefit of the Australian economy is set out in proposed section 39M of the IR&D Act and proposed clause 5 of this Bill (proposed subsection 73B(33) of the ITAA).

Section 39E : Adequate Australian content

- (e) Proposed section 39E requires the Board to formulate and publicise guidelines on what is meant by "research and development activities having an adequate Australian content" and sets out some of the criteria to be used in the formulation of the guidelines. The Board is precluded from certifying that activities on which expenditure has been incurred do not have an adequate Australian content if the activities complied with the guidelines that were in force when the expenditure was incurred. The guidelines are subject to parliamentary disallowance.

Section 39F : Registration of research agencies

- (f) Proposed section 39F provides for the registration of research agencies, which replace approved research institutes. There is no expenditure threshold for research by such agencies to qualify for the full 150% tax concession. Any body of persons may seek registration. The Board in conjunction with the Commissioner for Taxation is to establish criteria for registration and is required to register applicants that comply with the criteria. Registration is given in respect of specified research and development activities and is retrospective to the date on which the Board receives the application for registration, or, for agencies that were approved research institutes on 30 June 1988, is retrospective to 1 July 1988. The Board may, on application by a registered agency, vary the activities to which the agency's registration relates. The effective date of any such variation is the date that it is made. The Board is entitled to charge an applicant up to \$1,000 (or any higher amount prescribed by regulations) towards the cost of determining an applicant's qualifications to perform particular research and development activities. The Board is required to give reasons for refusing to register a body as a research agency or as an agency in respect of particular research activities. The criteria for registration are subject to Parliamentary disallowance.

Section 39G : Cancellation of registration of research agencies

- (g) Proposed section 39G provides for the Board to determine grounds on which the Board may cancel the registration of a research agency. One ground that the Board must include is a failure to continue after registration to meet a criterion of registration. Where the Board considers that a ground may exist to cancel the registration of an agency, the agency is to be allowed 90 days to show cause why its registration should not be cancelled. The Board is required to give notice to an agency of the reasons for the cancellation of its registration.

Section 39H : Board to publicise particulars of registered research agencies

- (h) Proposed section 39H requires the Board to publicise the names of registered research agencies and the classes of activities in respect of which they are registered. This is to be done in its annual report and by making the register available.

Section 39J : Registration of eligible companies

- (j) Proposed section 39J provides for the registration of companies who wish to seek tax deductions for their expenditure on research and development activities. A company is entitled to registration provided it gives the Board adequate information about its research and development activities and none of the prescribed grounds (see paragraph (k) below) exist for refusing to register the company. Registration relates to a particular year of income and the Board is required to give notice of its reasons for refusing registration. Registration once granted cannot be revoked.

Section 39K : Grounds for refusal to register eligible companies

- (k) Proposed section 39K provides for the grounds on which a company may be refused registration, principally that the proposed activities are not research and development activities. Other grounds may be specified in regulations, provided such grounds relate to a matter which the Board has power to determine.

Section 39L : Certificate as to research and development activities

- (l) Proposed section 39L, which is being transferred from section 73B of the Income Tax Assessment Act, requires the Board upon request from the Commissioner of Taxation to give a certificate to the Commissioner stating whether particular activities are research and development activities. The Board may also provide a certificate without prior request from the Commissioner.

Section 39M : Certificate as to exploitation of results, or Australian content, of activities

- (m) Proposed section 39M, which transfers and strengthens the provision currently in section 73B of the Income Tax Assessment Act, enables the Board to give a certificate that the results of research and development activities have not been exploited on normal commercial terms or for the benefit of the Australian economy or that the activities do not have an adequate Australian content. The phrases "exploited on normal commercial terms" and "benefit of the Australian economy" are defined in proposed sections 39C and 39D. Before a certificate is given the Board is required to afford the company concerned an opportunity (90 days) of showing that the results have been appropriately exploited or that the Australian content of the activities is adequate. The taxation consequence of a certificate under section 39M, which is set out in clause 5 of this Bill (proposed subsection 73B(33)), is that a deduction will not be allowed in respect of expenditure incurred on that activity.

Section 39N : Certificate of non-compliance

- (n) Proposed section 39N provides that the Board may require a company to give within 30 days relevant information to the Board about the company's research and development activities. If the company fails to give the information the Board may give a certificate to that effect to the Commissioner. The taxation consequence of such a certificate, which is set out in clause 5 (proposed sub-section 73B(33A)), is that a deduction will not be allowed for expenditure incurred on that activity. The company must be warned of the consequences of non-compliance. The purpose of the section is to prevent companies which have obtained tax benefits to which they are not entitled from frustrating the processes by which the Board might cause them to lose the deductions.

Section 39P : Joint registration

- (p) Proposed section 39P enables the Board to register several companies jointly in relation to a proposed project involving research and development activities. The Bill seeks to encourage companies ("portfolio investors"), which have no direct means to use the results of research and development, to invest in research and development ventures. In particular, it seeks to facilitate the performance of research and development ventures that are too large or risky for any one company to advance alone. Typically, arrangements to facilitate this form of investment involve promoters, researchers and investors. Proposed section 39P will provide, through the process of "joint" registration, a basis for prior "in principle" approval of the proposed venture so as to give some assurance to portfolio investors that they will be entitled to deductions under the 150% tax concession scheme in respect of their contributions to the arrangements. The proposed section will also empower the Board to preclude deductions for future expenditure if it is of the opinion that the venture is not progressing on the basis that was approved. Joint registration will be granted provided that the Board is satisfied that:
- (i) the proposed activities are research and development activities;
 - (ii) at least one of the companies is not related to the others (this will preclude related companies from exploiting the concession);
 - (iii) the total expenditure on the project will exceed \$1,000,000;
 - (iv) at least some of the companies would not be able to utilise the results of the research and development in their businesses and those companies will expend more than \$1,000,000 between them;

- (v) the results of the research and development will be exploited on normal commercial terms and for the benefit of the Australian economy; and
- (vi) the activities will have an adequate Australian content.

If it subsequently appears that any of the money paid by the jointly registered companies is not expended on research and development activities, the results of the expenditure have not been appropriately exploited, the activities do not have an adequate Australian content or any of the companies has disposed of its rights to the exploitation of the results of the research and development before the project is concluded, the Board may give a certificate to that effect. The taxation consequence of such a certificate which is set out in clause 5 (proposed subsection 73B(33B)), is that a deduction is not allowable for expenditure incurred. The Board is required, before giving a certificate to afford a reasonable opportunity to the company concerned to show cause why the certificate should not be given.

Section 39Q : Copies of certificate to be given to companies affected

- (q) Proposed section 39Q requires the Board to give a copy of a certificate, issued by it under this Part and given to the Commissioner of Taxation, to any company affected by the certificate.

Section 39R : Services of notices etc

- (r) Proposed section 39R allows notices and other documents to be served on companies by facsimile or similar transmission, as well as by the traditional means.

Clause 17 : Confidentiality

44 This clause provides that the obligation of confidentiality imposed on persons performing functions under the IR&D Act is to be extended to members of the staff assisting a committee of the Board.

Clause 18 : Transitional

45 This clause contains transitional provisions that:

- (a) deem companies registered under the present law to continue to be registered under the proposed new registration provisions; and
- (b) provide for pending applications for registration under the present law to be treated as though they had been made under the new provisions.

