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THE PARLIAMENT OF THE COMMONWEALTH
OF AUSTRALIA

THE SENATE

INCOME TAX ASSESSMENT AMENDMENT (RESEARCH AND DEVELOPMENT) BILL 1986

EXPLANATORY MEMORANDUM

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

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GENERAL OUTLINE

The Income Tax Assessment Amendment (Research and Development) Bill 1986 will amend the Income Tax Assessment Act 1936 to provide income tax deductions at the rate of 150% of certain expenditure incurred by Australian companies, during the period commencing on 1 July 1985 and ending on 30 June 1991, in respect of research and development activities (proposal announced on 29 May 1985).

FINANCIAL IMPACT

The estimated cost of the concession for expenditure in respect of research and development activities is $100m in 1986-87, $140m in 1987-88, rising to $160m in a full year.

MAIN FEATURES

The Bill will implement the proposal, announced on 29 May 1985, to provide a more generous income tax concession for research and development expenditure by Australian companies. Broadly, the new concession will provide a deduction of up to 150% of expenditure (other than expenditure on buildings) incurred on or after 1 July 1985 and before 1 July 1991 in respect of research and development activities that are carried on in Australia and do not otherwise attract government assistance. To be eligible for the concession, a company must be registered with the Australian Industrial Research and Development Incentives Board or the proposed new Industry Research and Development Board.

Research and development activities are defined in the Bill to mean systematic, investigative or experimental activities involving technical risk that are carried on for the purpose of acquiring new knowledge or creating new or improved materials, products, devices, processes or services, as well as directly related activities. Specifically excluded from the meaning of research and development activities is a range of activities such as marketing and quality control.

Except for expenditure on research and development activities contracted out to an approved research institute, the 150% rate of deduction will be available only where the amount of the expenditure for the purposes of the concession is $50,000 or more in respect of the year of income. Where annual expenditure is less than $50,000 but more than $20,000, a deduction will be available at a phased-in rate of between 100% and 150%. Expenditure on research and development activities carried out by an approved research institute on behalf of an eligible company will attract the 150% rate of deduction irrespective of the level of that expenditure.

Expenditure on plant used exclusively in research and development activities (including up to $10 million of expenditure on a unit of pilot plant) is to be deductible at the relevant increased rate over 3 years, with one-third of such expenditure being taken into account in determining the level of total qualifying research and development expenditure in each year and thus the relevant rate of deduction. Also to be taken into account for this purpose is one-third of expenditure on buildings, or building extensions, alterations or improvements, used exclusively in research and development activities, although such expenditure will itself continue to be deductible at the rate of 100% over 3 years.

A more detailed explanation of the provisions of the Bill is contained in the following notes.

Clause 1 : Short title, &c.

Sub-clause (1) of this clause provides for the amending Act to be cited as the Income Tax Assessment Amendment (Research and Development) Act 1986.

Sub-clause (2) facilitates references to the Income Tax Assessment Act 1936 which, in the amending Act, is referred to as "the Principal Act".

Clause 2 : Commencement

Under clause 2, the amending Act is to come into operation on the day on which it receives the Royal Assent. But for this clause, the Act would, by virtue of sub-section 5(1A) of the Acts Interpretation Act 1901, come into operation on the twenty-eighth day after the date of Assent.

Clause 3 : Divisible deductions

This clause proposes technical amendments of section 50G, one of the "current year loss" provisions of Subdivision B of Division 2A of Part III of the Principal Act. The amendments are consequential upon the proposed insertion in the Principal Act (by clause 7 of the Bill) of new section 73B to authorise special deductions in respect of expenditure on research and development activities.

In broad terms, the current year loss provisions divide an income year into "relevant periods" that are separated by a "disqualifying event", e.g., on the occurrence of a 50% or greater change in shareholders' dividend, capital or voting rights. A net loss incurred in one relevant period is not to be offset against net income derived during another relevant period of the same year unless the company satisfies a "continuing ownership" test or the alternative "same business" test.

For the purposes of these provisions, section 50G describes a category of deductions as "divisible deductions" and directs how such deductions are to be taken into account under the provisions. Very broadly, divisible deductions are those allowable deductions of a year of income which are apportioned or spread in an appropriate manner over the relevant periods of the company in relation to the year of income for the purpose of determining the notional taxable income or notional loss of the company in relation to each of its relevant periods.

The amendments proposed by clause 3 will ensure that, where a company suffers a disqualifying event, a deduction authorised in respect of plant under new sub-section 73B(15), or in respect of buildings under new sub-section 73B(17), will be treated as a divisible deduction and apportioned between relevant periods on a pro-rata basis in the year of income in which the event occurs. A detailed discussion of sub-sections 73B(15) and (17) follows in the later notes on clause 7.

Clause 4 : Depreciation

This clause proposes the insertion of a new sub-section in section 54 - the general depreciation deduction provision - of the Principal Act. That new sub-section (sub-section 54(11)) provides that ordinary depreciation is not to be allowed as a deduction in respect of plant installed ready for use, and held in reserve for use, exclusively in research and development activities as defined in proposed new section 73B, being inserted in the Principal Act by clause 7.

In terms of new sub-section 73B, deductions in respect of expenditure on plant for use exclusively in research and development activities are to be allowed over 3 years, the first year being that in which the plant commences to be so used. New sub-section 54(11) will ensure that ordinary depreciation deductions are not allowed for plant during any period prior to its first use exclusively in research and development activities. As explained in following notes, while double deductions will be precluded, ordinary depreciation may be allowed where plant ceases to be used exclusively in research and development activities. Where the cost of pilot plant exceeds $10 million, the concessional deduction under section 73B will apply only to that amount and over the first 3 years of use exclusively for research and development activities. After those 3 years, the ordinary depreciation provisions will apply in respect of that excess. Under proposed new sub-section 73B(18), an eligible company may elect that section 73B not apply in respect of plant, in which case new sub-section 54(11) would also not apply.

Clause 5 : Calculation of depreciation

Section 56 of the Principal Act provides for the calculation of the depreciation deductions ordinarily allowable for income tax purposes in respect of a unit of property and sub-section 56(3) provides that, generally, the cost of a unit of property for depreciation purposes is to be reduced by any other income tax deductions allowed or allowable in respect of the property. Certain such other deductions that are allowed over and above depreciation deductions are, however, excluded from the operation of sub-section 56(3) - for example, investment allowance deductions.

Clause 5 will insert in sub-section 56(3) an appropriate reference to new section 73B so that, where the higher concessional rate of deduction is allowed under that section in respect of plant used exclusively in research and development activities, that deduction does not reduce the cost of the plant for ordinary depreciation purposes. Instead, special provisions in section 73B (see notes on clause 7) will reduce the cost of plant for those purposes where plant ceases to be used exclusively in research and development activities before its cost is written-off under that section. In those circumstances, ordinary depreciation allowable will be calculated on the basis of a notional written-down value, exclusive of the additional (up to 50%) deduction allowed in respect of the plant under section 73B.

Clause 6 : Disposal, loss or destruction of depreciated property

This clause proposes the insertion of new sub-section (2AA) into section 59 of the Principal Act as a consequence of the proposed insertion in the Principal Act (by clause 7 of the Bill) of new section 73B to authorise deductions in respect of expenditure on research and development activities.

Section 59 of the Principal Act provides that, where a depreciated asset is disposed of, lost or destroyed at any time in a year of income, any amount by which its depreciated value exceeds the consideration receivable is an allowable deduction in that year (under sub-section 59(1)). On the other hand, where the consideration receivable exceeds the depreciated value, the excess, to the extent of depreciation allowed, is included in the assessable income (by the application of sub-section 59(2)).

Where expenditure on a unit of plant becomes eligible for deductions under the ordinary depreciation provisions of the income tax law, after having received special deductions under section 73B, and that plant is disposed of, lost or destroyed, the provisions of section 59 are to have effect. Where the consideration received

exceeds the written-down value of the plant and the recoupment of depreciation allowed is to be included in assessable income, that recoupment will, as a result of the new sub-section 59(2AA), also take into account the amount of the cost of the unit of plant in respect of which deductions under sub-section 73B(15) were allowed. It does this by deeming those amounts to have been allowed in respect of depreciation.

Clause 7 : Expenditure on research and development activities

Introductory note

Clause 7 will insert new section 73B in Division 3 of Part III of the Principal Act. The provisions of section 73B will provide a concessional rate of deduction of up to 150% for certain expenditure incurred by eligible companies on or after 1 July 1985 and before 1 July 1991 in respect of research and development activities carried on in Australia. The research and development concession is to be available only to companies incorporated in Australia under a law of the Commonwealth, a State or Territory, including government-related companies established pursuant to specific Acts. The concession will be further restricted to companies acting on their own behalf and not in the capacity of a trustee or nominee of another entity. To qualify for the concession, a company will need to be registered with the Australian Industrial Research and Development Incentives Board or the proposed new Industry Research and Development Board.

Subject to satisfaction of the threshold test discussed below, expenditure incurred by an eligible company on salaries, wages and directly related overhead costs associated with research and development activities will qualify for the concession in the year of income in which the expenditure is incurred. Also, subject to satisfaction of that test, expenditure on plant and equipment used exclusively in research and development activities will attract deductions - increased at the appropriate rate - over 3 years. Adjustment on disposal, loss or destruction of eligible plant and equipment will not reflect the increased deductions allowed but rather the actual deductible expenditure. Ordinary depreciation will generally be denied in respect of eligible plant and equipment while it is used exclusively in research and development activities. In relation to a unit of pilot plant, the concessional rate of deduction will be limited to the first $10 million of expenditure incurred. After the first 3 years of exclusive use of pilot plant in research and development activities, any excess of its cost over $10 million will be eligible for ordinary depreciation deductions.

Capital expenditure incurred by an eligible company in the acquisition or construction of buildings, or of extensions, alterations or improvements to buildings, used exclusively for research and development activities will not itself attract the concessional rate of deduction but will be taken into account for the purposes of the threshold test. Such expenditure is to be written-off over 3 years in a similar manner to the present application of section 73A of the Principal Act (which applies to buildings used for business-related scientific research purposes). An eligible building must generally be used in research and development activities for 5 years to come within the scope of section 73B.

Expenditure in respect of research and development projects that are funded to any extent by the Commonwealth, a State or Territory or an authority thereof will be ineligible for deduction under section 73B.

An eligible company must incur a minimum amount of relevant expenditure in a year of income to be entitled to the concessional rate of deduction, except where the research and development activities are contracted out to an approved research institute (as defined in sub-section 73A(6) of the Principal Act). This expenditure threshold for the 150% rate of deduction is to be an amount of $50,000. A proportional rate of increase in deductions will be available for amounts of expenditure in the range from $20,001 up to $49,999. For the purposes of applying the threshold test in a year of income, account is to be taken of expenditure on plant, equipment and buildings to the extent that the expenditure attracts section 73B deductions in that year.

More detailed notes follow.

Sub-section 73B(1) contains definitions of a number of terms used in new section 73B. Each term is to have the stated meaning unless the contrary intention appears.

"aggregate research and development amount" means the sum of each of the amounts of expenditure that may qualify for deduction under section 73B in a year of income. It is this aggregate amount to which regard is had for the purposes of the expenditure threshold test and thus in determining the relevant rate of deduction.

The amounts of expenditure that comprise the "aggregate research and development amount" for an eligible company for a year of income are -

- the "research and development expenditure" (also a defined term) incurred by the company in that year of income (paragraph (a) of the definition);

- one-third of the company's total qualifying plant expenditure for that year of income (paragraph (b) of the definition); and

- one-third of the company's total qualifying building expenditure for that year of income (paragraph (c) of the definition).

The terms "plant expenditure" and "building expenditure" are also defined in sub-section 73B(1) and qualifying such expenditure is determined in accordance with sub-section 73B(4) (see later notes). One-third of qualifying plant and qualifying building expenditure is taken into account in the year in which the eligible company commences to use the unit of plant or the building and in each of the 2 succeeding years.

"annual leave" is defined as having the same meaning as that term has in sub-section 26AC(4) of the Principal Act. Broadly, such leave is that described as, or determined on a similar basis to, annual leave, recreation leave or annual holidays, entitlement to which arises under a law of the Commonwealth, a State or Territory, under an award, determination or industrial agreement or under a contract of employment or the terms of appointment to an office.

The term is relevant to the definition of "salary expenditure", which may include all or some of the expenditure incurred by an eligible company on employees' annual leave and which may form part of "research and development expenditure" (also defined) to which section 73B applies.

"approved research institute" has the same meaning as the term has in section 73A of the Principal Act - that is, it means -

- the Commonwealth Scientific and Industrial Research Organisation (CSIRO); or

- any university, college, institute, association or organisation approved in writing by the CSIRO, by the Secretary to the Department of Health or by the Secretary to the Department of Employment and Industrial Relations as an institution, association or organisation for undertaking scientific research which is or may prove to be of value to Australia.

"Board" is defined as meaning the Industry Research and Development Board that is being established by the Industry Research and Development Bill 1986. The Board is to perform functions in accordance with, or relevant to, sub-sections 73B(11), (12), (33), (34) and (35) (see notes on those new sub-sections).

"building", as that term is used in section 73B, is to include part of a building.

"building expenditure" is expenditure which may be written-off under section 73B in equal instalments over 3 years. To qualify, the expenditure must be of a capital nature and be incurred by an eligible company in respect of a building, or an extension, alteration or improvement to a building owned or leased by the company, for use exclusively in research and development activities. Where the expenditure is in respect of the acquisition, or the construction by another person, of the building or extension, etc., it must be incurred under a contract entered into during the "deduction period" (a defined term) - that is, on or after 1 July 1985 and before 1 July 1991 (paragraph (a)) of the definition). Where the expenditure is in respect of the construction of the building, extension, etc., by the eligible company itself, the construction must commence during the "deduction period" (paragraph (b)) of the definition).

"consideration receivable" - a term relevant where plant or buildings are disposed of, lost or destroyed (see, in particular, the notes on sub-sections 73B(23) to (27)) - is defined as having the same meaning as that term has in sub-section 59(3) of the Principal Act. In terms of that sub-section, it means -

- on a sale of property - the selling price less expenses of sale;

- on loss or destruction of property - the amount or value received or receivable in respect thereof under an insurance policy or otherwise;

- on a sale where the property is sold with other assets and no separate value is allocated to the property - an amount determined by the Commissioner of Taxation; and

- where the property is disposed of otherwise than by sale - the value of the property at the disposal date.

"contracted expenditure" is the term used to describe expenditure incurred by an eligible company in having an "approved research institute" perform research and development activities on behalf of the company. There is no minimum amount of such expenditure necessary for it to qualify under section 73B for deduction at the rate of 150% (see notes on sub-section 73B(13)) but, to qualify, the expenditure must be incurred and the activities performed during the "deduction period" - that is, the period commencing on 1 July 1985 and ending on 30 June 1991.

A gift made to an approved research institute would not constitute contracted expenditure. Nor could it be said that an approved research institute was performing research and development activities on behalf of a company if the company were not entitled to receive the results of the research and development activities.

"contributions to superannuation funds" is a term relevant to the components of "salary expenditure" (also a defined term). Such contributions are those made by an employer to provide superannuation benefits for employees or for dependants of employees, being contributions that would, if they were not deductible under section 73B, be deductible under section 82AAC of the Principal Act.

"deduction acceleration factor" is the term used to describe the factor by which relevant qualifying expenditure is to be multiplied in determining deductions allowable under section 73B. It effectively represents the extent to which certain deductions (see notes on sub-sections 73B(14) and (15)) are to be

allowed at a rate greater than 100% and up to 150% where the "aggregate research and development amount" (see earlier notes on the definition of that term) is more than $20,000 in a year of income.

In a case where the aggregate research and development amount is in the range from $20,001 to $49,999 in a year of income (paragraph (a) of the definition), the deduction acceleration factor is to be ascertained in accordance with the formula $\frac{11A - 100,000}{6A}$. The component A in the formula is the aggregate research and development amount expressed in whole dollars. As an example of the application of the formula, where the aggregate research and development amount for an eligible company in a year of income is $45,000, the deduction acceleration factor would be 1.4630 (rounded to 4 decimal places) - that is, $\frac{(11 \times 45,000) - 100,000}{6 \times 45,000}$.

In a case where the aggregate research and development amount is $50,000 or more (paragraph (b) of the definition), the deduction acceleration factor is 1.5.

"deduction period" describes the period of time during which, broadly, expenditure must be incurred to qualify for the section 73B concession. That is the period that commenced on 1 July 1985 and ends on 30 June 1991.

"eligible company" means a body corporate that is incorporated under a law of the Commonwealth, a State or Territory. Only an eligible company is to be entitled to the concession provided by section 73B. In terms of sub-section 73B(3), a company acting in the capacity of a trustee or nominee cannot be an eligible company.

The term eligible company would also include a body corporate established by a specific Act of the Commonwealth, a State or Territory - that is, other than under a general companies code.

"ineligible pilot plant amount" describes the excess of the actual cost of a unit of pilot plant over $10 million. In terms of sub-section 73B(6), the cost of a unit of

pilot plant for the purposes of the section 73B concession is limited to $10 million. Where the actual cost of a unit of pilot plant was, for example, $25 million, its cost for concession purposes would be deemed by sub-section (6) to be $10 million and the balance of $15 million (the ineligible pilot plant amount) would not attract the concession. After the first 3 years of exclusive use of the unit in research and development activities, the ineligible pilot plant amount would be eligible for ordinary depreciation deductions.

"long service leave" is defined as having the same meaning as that term has in sub-section 26AD(8) of the Principal Act. Broadly, such leave means long service leave, long leave, furlough, extended leave or leave of a similar kind (however described), entitlement to which arises under a law of the Commonwealth, a State or Territory, under an award, determination or industrial agreement, under a contract of employment or the terms of appointment to an office or under certain other leave arrangements.

The term is relevant to the definition of "salary expenditure", which may include all or some of the expenditure incurred by an eligible company on employees' long service leave and which may form part of "research and development expenditure" (also defined) to which section 73B applies.

"pilot plant" means an experimental model (not itself for commercial use but with the intended essential characteristics of the plant of which it is a model) of plant for use in either research and development activities or commercial production.

Essentially, a unit of pilot plant is the forerunner of a unit of commercial plant or research and development plant and would include a prototype or a non-functioning model of plant intended to be produced.

"plant" means property that is plant or articles for the purposes of the general depreciation provision - section 54 - of the Principal Act.

"plant expenditure" is expenditure which may be written-off over 3 years, with deductions being allowed at a rate greater than 100% and up to 150% where the "aggregate research and

development amount" (see earlier notes on the definition of that term) is more than $20,000 in a year of income. To qualify, the expenditure must be incurred by an eligible company on a unit of "plant" (as defined) for use exclusively in research and development activities. Where the expenditure is in respect of the acquisition, or the construction by another person, of the unit of plant, it must be incurred under a contract entered into during the "deduction period" - that is, on or after 1 July 1985 and before 1 July 1991 (paragraph (a) of the definition). Where the expenditure is in respect of the construction of the unit of plant by the eligible company itself, the construction must commence during the "deduction period" (paragraph (b) of the definition).

"research and development activities" is a term that is fundamental to the operation of new section 73B. It is only these activities expenditure in relation to which can qualify for the concession provided by the section. These activities must be systematic, investigative or experimental activities (paragraph (a) of the definition) and must -

- be carried on in Australia or an external Australian Territory (sub-paragraph (i));
- involve innovation or technical risk (sub-paragraph (ii)); and
- be carried on for the purpose of either acquiring new knowledge (whether it will have a specific practical application or not) or creating new or improved materials, products, devices, processes or services (sub-paragraph (iii)).

Other activities carried on for a purpose directly related to the carrying on of activities of the above-mentioned kind are also research and development activities, provided those directly related activities are carried on in Australia or an external Australian Territory (paragraph (b) of the definition).

For the purposes of the definition of "research and development activities", the reference to systematic investigative or experimental activities means that the

scientific method is applied in a systematic progression of work from hypothesis to experiment, observation and evaluation, followed by logical conclusions. The work will pertain to, or be predicated upon, principles of physical sciences, biological sciences, chemical sciences, medical sciences, engineering, or computer science.

The reference to innovation or technical risk pertains to work elements that are primarily experimental in nature, are innovative, involve substantial risk, and are essential to attaining the primary objective.

A basic criterion associated with determination of "innovation" is the presence of an appreciable element of novelty. This may be assessed according to several criteria, including whether -

- the work is seeking previously undiscovered phenomena, structures or relationships;
- the work is attempting to apply knowledge or techniques in a new way;
- the outcomes are likely to benefit more than one organisation; or
- the results are expected to be patentable.

"Technical risk" addresses the principle of uncertainty. This requires that the probability of obtaining a given technical objective cannot be known or determined in advance on the basis of current knowledge or experience - that is, the outcome cannot be predicted with certainty. The technological or scientific uncertainty can only be removed through a program of systematic investigation, experimentation and analysis.

The requirement that systematic, investigative or experimental activities be carried on for the purpose of acquiring new knowledge (whether or not it will have a specific practical application) or creating new or improved materials products, devices, processes or services may be considered as requiring the existence of one or more of the following elements:

- Basic research - namely, experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any particular application or use in view.

- Applied research - namely, work undertaken for the advancement of knowledge with a specific practical application in view. It involves the consideration of the available knowledge and its extension in order to solve particular problems. The results of applied research are intended primarily to be valid for a single or limited number of products, operations, methods and systems. Applied research develops ideas into operational form.

- Experimental development - namely, systematic work using the results of basic or applied research and/or practical experience for the purpose of creating new, or improving existing, materials, devices, products, processes or services.

The reference to other directly-related activities makes provision for activities which are integral to, and are undertaken in direct support of, a research and development activity.

Without limiting the range of other activities that may be included, but subject to the requirement that there must be direct links to research and development activities, the activities referred to are:

- Industrial design - that is, a creative activity the aim of which is to determine the formal qualities of objects to be ultimately produced by industrial processes. These formal qualities are not only the external features but principally those structural, functional and ergonomic relationships which convert a system to a coherent unity both from the point of view of the producer and the user.

- Engineering design - that is, aspects included in industrial design requiring engineering expertise in consideration of structure, function and materials.

- Production engineering - that is, consideration of aspects including design related to the means and structure of production processes or technology for which the outcome was not predictable.

- Operations research - that is, the improvement of the efficiency of organisations by techniques of numerical analysis.

- Mathematical modelling and analysis.

- Psychological research.

- Computer software development - The eligibility of software research and development which forms part of another research and development project will generally be dependent on the eligibility of that project being established. Provided the general definition of research and development activities is met, computer software developed for the purpose of sale, rent, licence, hire or lease to multiple clients may qualify. Routine computer programming or in-house software development would generally not satisfy the requirement.

- The design, construction and operation of prototypes, where the primary objective is technical testing or to make technical improvements. A prototype is an original model on which something new is patterned. It is a basic model possessing the essential characteristics of the intended product; it is not an item intended for sale in its own right. The design, construction and testing of prototypes normally falls within the scope of research and development activities. This applies whether only one or several prototypes are made and whether they are made consecutively or simultaneously. However, when any necessary modifications to the prototype(s) have been made and testing has been satisfactorily completed, the boundary of the scientific method has been reached. The demonstration of the prototype or construction of copies

after this stage, even if undertaken by research staff, would not qualify as part of the research and development activity.

- Feedback research and development, where directed at problem solving beyond the research and development phase, e.g., technical problems arising during initial production runs. Trial production runs or "experimental production", including tooling-up for full-scale production (tool-making and tool-try-out), would not qualify as part of research and development activity. After a new product or process has been turned over to production, however, there may still be technical problems to be solved, some of which demand further feedback research and development directed at solving these problems.

Certain activities that might otherwise fall within the meaning of "research and development activities" are specifically excluded from the meaning of that term by sub-section 73B(2) - see notes on that sub-section.

"research and development expenditure" is expenditure (not being expenditure in the acquisition or construction of plant, or of a building, extension, alteration or improvement to a building), deductions in respect of which may be allowed under section 73B at a rate greater than 100% and up to 150% where the "aggregate research and development amount" (see earlier notes on the definition of that term) exceeds $20,000 in a year of income. To qualify, the expenditure must be incurred by an eligible company during the year of income and must be -

- "contracted expenditure" (see earlier notes on the definition of that term) - paragraph (a);

- "salary expenditure" (see later notes on the definition of that term) incurred during the period commencing on 1 July 1985 and ending on 30 June 1991 - paragraph (b); or

- other expenditure incurred during the period commencing on 1 July 1985 and ending on 30 June 1991 in respect of

"research and development activities" (see the preceding notes) that are carried on during that period by or on behalf of the eligible company - paragraph (c).

"salary expenditure" - a component of "research and development expenditure" (see the preceding notes on the definition of that term) - means the sum of the following amounts of expenditure incurred by an eligible company during a year of income -

- expenditure directly in respect of "research and development activities" (see earlier notes on the definition of that term) carried on by or on behalf of the company during the period 1 July 1985 to 30 June 1991 that is incurred on company officers' or employees' salaries, wages, allowances, bonuses, overtime payments or penalty rate payments (paragraph (a) of the definition);

- in proportion to the time during the year of income that a company officer or employee was engaged in the research and development activities, so much of the expenditure incurred by the company during the year in respect of "annual leave", "sick leave" or "long service leave" (each term defined) for the officer or employee (paragraph (b)); and

- a reasonable amount (as determined by the Commissioner of Taxation) of the expenditure incurred by the company during the year of income on pay-roll tax and workers' compensation insurance premiums (paragraph (c)).

In determining a reasonable amount of "salary expenditure" on pay-roll tax or workers' compensation insurance premiums, the Commissioner is required to have regard to the amount of expenditure incurred by the company during the year of income on salaries, wages, allowances, bonuses, overtime payments, penalty rate payments and leave payments that is related to research and development activities. He is also required to have regard to the total amount of such expenditure related to all activities of the company during the year of income and any other matters considered relevant.

Pay-roll tax expenditure by an eligible company would be "salary expenditure" in the proportion that all relevant expenditure by the company bears to relevant expenditure in respect of research and development activities but taking into account any pay-roll tax exemptions or concessions available to the company. Similarly, workers' compensation insurance premiums incurred by the company and accepted as "salary expenditure" would reflect, for example, any concessions or discounts allowed to the company.

"sick leave", as with the terms "annual leave" and "long service leave" (see notes on those definitions), is a term relevant to the definition of "salary expenditure". It means any leave period in excess of 14 consecutive days that is granted by an employer to an employee in respect of the employee's physical or mental incapacity. Expenditure relevant to the provision of leave for a period of 14 consecutive days or less would ordinarily be accepted as "salary expenditure" on the basis that it is incurred by way of salary or wages.

"undeducted building expenditure" is the amount of "building expenditure" (as defined) that has not been allowed as a deduction under section 73B - specifically sub-section 73B(17). The term is relevant in determining whether a deduction is allowable or an amount is included in assessable income on destruction or disposal of a building, or an extension, alteration or improvement thereto, that has attracted section 73B deductions (see notes on sub-section 73B(25) to (27).

"written-down value" is a term applied to a unit of plant owned by a company and in respect of which the company has been allowed a section 73B deduction. The written-down value of such a unit of plant is a notional value at which the plant is taken to have been acquired by the company for ordinary depreciation purposes - see notes on sub-sections 73B(21) and (22). Broadly, ordinary depreciation becomes available in respect of the plant where it ceases to be used exclusively in research and development activities before it is written-off under section 73B or where, in the case of pilot plant with a cost in excess of $10 million, the first $10 million has been written-off under the section.

The written-down value of plant is also relevant for the purposes of determining the further deduction allowable under section 73B, or the extent to which deductions already allowed are to be recouped, on the disposal, loss or destruction of plant - see notes on sub-sections 73B(23) and (24).

The written-down value of plant, other than pilot plant the cost of which was in excess of $10 million, is determined by application of the formula $A - \frac{AB}{3}$, with component A representing the cost of the plant and component B the number of years in respect of which the company has been allowed a section 73B deduction for the plant (paragraph (a) of the definition). For example, the written-down value, as at the beginning of the third year of its use exclusively in research and development activities, of plant that cost $54,000 would be $18,000, that is - $54,000 - $\frac{\$54,000 \times 2}{3}$.

The written-down value of pilot plant the cost of which exceeded $10 million is determined by application of the formula $A - \frac{\$10,000,000B}{3}$, with component A representing the actual cost of the plant and component B the number of years in respect of which the company has been allowed a section 73B deduction (paragraph (b) of the definition). In the example set out in the preceding paragraph, if the plant referred to was pilot plant that cost $18 million, its written-down value at the particular time would be $11,333,333, that is $\$18m - \frac{\$10m \times 2}{3}$, rounded to whole dollars.

New sub-section 73B(2) qualifies the meaning of the term "research and development activities", as defined in sub-section (1), by specifically excluding certain activities such as market research, testing or development, quality control and the making of donations. Those excluded activities are specified in paragraphs (a) to (h) of sub-section (2).

While a precise cut-off point between research and development activities on the one hand, and other activities on the other, cannot be given for all situations, the basic intent is that, if the primary objective is to make further technical improvements on a product or process, then the work comes within the

definition of development. However, if the product, process or approach is substantially set and the primary objective is to develop markets, to do pre-production planning or to get production or control systems working smoothly, then the work is no longer development.

Without limiting the specific activities which may fall within or outside the definition of research and development activities on the basis of the primary criteria, certain activities which may be seen as being close to research and development but nevertheless fall outside of the definition are -

- pre-production activities such as planning or demonstration of commercial viability, tooling-up, trial and production runs;
- routine data collection, except where such activities are part of the research and development process;
- preparing for teaching;
- commercial, legal and administrative aspects of patenting, copyrighting or licensing activities;
- costs associated with standards compliance - that is, the maintenance of national standards, the calibration of secondary standards and routine testing and analysis of materials, components, products, processes, soils, atmospheres, etc;
- specialised routine medical care;
- any duplication of commercial products or processes - "duplication" means any activity related to reproduction of a commercial product or process arising from physical examination of an existing system or from plans, blueprints, detailed specifications or publicly available information.

Sub-section 73B(3) excludes from eligibility for section 73B deductions a company acting in the capacity of a trustee or a nominee. This ensures that only companies acting on their own behalf can receive the benefit of the special deductions available under the section.

Sub-section 73B(4), which is subject to sub-section (5), is an interpretative provision establishing, for the purposes of the section, the meaning of the terms "qualifying plant expenditure" and "qualifying building expenditure". Both of these terms are relevant for the purpose of the definition of "aggregate research

and development amount" as discussed above in the notes on the definitions in sub-section (1). "Qualifying plant expenditure" is also important in the application of sub-section 73B(15), which is the provision allowing the deduction of the cost of plant over the first 3 years in which it is used exclusively for research and development activities. Similarly, "qualifying building expenditure" is integral to the operation of sub-section 73B(17), which provides for the cost of a building or an extension, alteration or improvement to a building used exclusively for research and development activities to be deductible in equal instalments over 3 years.

Paragraph 73B(4)(a) relates to expenditure which is "plant expenditure" (as defined in sub-section 73B(1)) incurred by an eligible company during a year of income, and before 1 July 1991, in respect of a unit of plant which the company commences to use during the year exclusively for the purpose of the carrying on, by or on behalf of it, of research and development activities. The amount of that expenditure is taken to be "qualifying plant expenditure" and, as such, one-third of that expenditure is taken into account in that year of income and the next 2 years of income in ascertaining the "aggregate research and development amount" for each of those 3 years.

A similar approach is taken under paragraph 73B(4)(b) with respect to building expenditure. Where an eligible company has incurred "building expenditure" (as defined in sub-section 73B(1)) in relation to a building, or an extension, alteration or improvement to a building, which it commences to use, during a year of income, exclusively for the purposes of the carrying on, by or on behalf of the company, of research and development activities, that amount of expenditure is taken to be an amount of "qualifying building expenditure". This means that one-third of that expenditure is taken into account in that year of income and the 2 following years of income in ascertaining the "aggregate research and development amount" for each of those years.

The operation of sub-section 73B(5) is to disqualify as "qualifying plant expenditure" or "qualifying building expenditure" (in terms of sub-section (4)) expenditure incurred by an eligible company on a unit of plant or a building or an extension, alteration or improvement to a building, where that plant, building, extension, alteration or improvement, as the case may be, ceases to be used, within the first 3 years of use by that company, exclusively for the purpose of the carrying on of research and development activities. In those circumstances, the sub-section will apply in relation to that year and any succeeding year where that expenditure would have been "qualifying plant expenditure" or "qualifying building expenditure", as the case may be.

In the case of expenditure on plant, however, by the operation of proposed sub-section 73B(21), the "written-down value" (as defined) of that plant may be subject to further deduction under any applicable provisions of the Principal Act - for example, the depreciation provisions. Where a building or an extension, alteration or improvement to a building ceases in the first 3 years of use by the company to be used exclusively for the purpose of carrying on research and development activities by or on behalf of the company, apart from the effect of sub-section 73B(5), the provisions of proposed sub-section 73B(28) - see notes on that sub-section and sub-sections 73B(29) and (30) - may mean that the disqualification as "qualifying building expenditure" also applies to any years of income prior to the year in which it ceases to be used exclusively by the company for research and development purposes.

Where the cost of any unit of pilot plant (as defined) exceeds $10 million, proposed sub-section 73B(6) will limit the cost to be taken into account for the purposes of section 73B to $10 million. No benefit is available under that section for the cost of a unit of pilot plant in excess of $10 million. However, after the 3 years application of section 73B to the first $10 million of the cost of a unit of pilot plant, any excess of that cost may, under proposed new sub-section 73B(22), be eligible for deduction under any other relevant provisions of the Principal Act.

Should an eligible company prefer that deductions in respect of a unit of plant be allowed under other provisions of the Principal Act rather than section 73B, an option to that effect will be exercisable pursuant to proposed sub-section 73B(18) - see notes on that sub-section.

By virtue of new sub-section 73B(7), a building will not be regarded as having ceased to be used exclusively for the carrying on of research and development activities merely because its use for that purpose was halted by a temporary cessation of those activities to enable the construction of an extension, alteration or improvement to, or the making or repairs to, that building - paragraph (a) of the sub-section. Paragraph (b) of sub-section 73B(7) also allows a building to be regarded as being used exclusively for the carrying on of research and development activities at a particular time if, at that time, it is maintained ready for use for that purpose and is not used or for use for any other purpose, provided that its use for the carrying on of research and development activities has not been abandoned.

Sub-section 73B(8) proposes that no deduction be allowable under section 73B in respect of any of a company's expenditure on a project which is funded to any

extent under a grant provided by the Commonwealth, a State or Territory or by any statutory authority, or where any of the company's expenditure on the project is reimbursed, or becomes entitled to be reimbursed, by the Commonwealth, a State or Territory or by a statutory authority. That expenditure is also to be disregarded for the purposes of ascertaining the "aggregate research and development amount" (as defined) in respect of the company in any year. The section of the Principal Act relating to the amendment of income tax assessments - section 170 - is, by clause 8 of this Bill, to be amended to allow assessments to be re-opened to give effect to sub-section 73B(8).

The effect of proposed sub-section 73B(9) is to deny an eligible company the benefit of deductions under section 73B in respect of expenditure incurred by the company in carrying on research and development activities on behalf of another person and such expenditure is not taken into account for the purposes of ascertaining the "aggregate research and development amount" in respect of that company. Without this sub-section, it would be possible for each of two companies - the one on behalf of which the research and development activities are performed and the one performing those activities - to obtain section 73B deductions in respect of the same program of research and development activities.

Sub-sections (10) to (12) of section 73B contain provisions in relation to the registration procedure necessary for a company to become entitled to deductions under that section. Sub-section 73B(10) stipulates that no deduction under section 73B is allowable to an "eligible company" (as defined) unless it is registered under sub-section 73B(12) in relation to the year of income to which the relevant expenditure relates. Under sub-section 73B(11), an eligible company may apply for registration in accordance with a form approved by the Industry Research and Development Board (or, before the establishment of that Board, by the Australian Industrial Research and Development Incentives Board - see the notes on clause 9 of the Bill regarding the transitional arrangements relevant to the registration procedure). Where an application has been made by an eligible company under sub-section (11) and any information on the company's research and development activities, that is reasonably required by the Board at the time, has been provided by the company, the Board shall, in accordance with sub-section 73B(12), register the company in relation to such a year or years of income (before or after the one in which the application was made) as the Board determines.

Where an eligible company incurs expenditure in a year of income in having research and development activities performed on its behalf by an approved research institute, that "contracted expenditure" (as defined) is, by virtue of new sub-section 73B(13), deductible at the

increased rate of 150% - whatever the level of that expenditure - from the company's assessable income of that year.

Sub-section 73B(14) is one of the principal operative provisions of section 73B under which the increased deductions of up to 150% for eligible research and development expenditure are to be made available. Where - under paragraph (a) of that sub-section - an eligible company incurs "research and development expenditure" (as defined), but not including contracted expenditure (to which sub-section 73B(13) applies), and - under paragraph (b) - the company has an aggregate research and development amount of more than $20,000 in relation to the year of income, the amount of that expenditure is multiplied by the "deduction acceleration factor" (as defined) and the resultant amount is an allowable income tax deduction to the company for that year of income. An illustration of the operation of sub-section (14) would be where, in a year of income, an eligible company incurred expenditure of $10,000 on the purchase of certain materials to be used exclusively by the company in carrying on its research and development activities and, in relation to that year of income, the "aggregate research and development amount" for the company was $60,000. As that latter amount exceeds $50,000, the maximum deduction acceleration factor of 1.5 would apply and the deduction allowable under sub-section 73B(14) in respect of the expenditure of $10,000 would be increased to $15,000. On the other hand, if, in that example, the aggregate research and development amount in relation to the company was only $40,000, the application of the formula in paragraph (a) of the definition of "deduction acceleration factor" would produce a factor of 1.4167 (calculated to 4 decimal places) and a deduction of $14,167 would be allowable to the company.

A similar process applies under proposed sub-section 73B(15), another of the principal operative provisions of section 73B. In accordance with sub-section (15), where, in the year of income that an eligible company commences to use a unit of plant exclusively for the purpose of the carrying on by or on behalf of that company of research and development activities, or in either of the next 2 years of income, there is an amount of "qualifying plant expenditure" (see notes on sub-section 73B(4)), certain deductions are allowable under sub-section (15). Paragraph (a) of sub-section (15) relates to cases where the "aggregate research development amount" (as defined) is greater than $20,000. In these cases, one-third of the qualifying plant expenditure is multiplied by the deduction acceleration factor (as previously discussed) and the resultant amount is allowable as an income tax deduction to the company in the year of income in which the company first uses that unit of plant exclusively for research and development purposes. In each of the next 2 years of

income, provided that exclusive use continues, one-third of that qualifying plant expenditure is multiplied by that year's deduction acceleration factor in relation to the company and the resultant amount allowable as a deduction. Paragraph 73B(15)(b) applies in those cases where in a particular year of income the aggregate research and development amount is $20,000 or less. In such cases, the deduction allowable in relation to the year of income in respect of the qualifying plant expenditure is one-third of the amount of that expenditure without any increase.

By way of illustration of the application of sub-section (15), an eligible company may have incurred qualifying plant expenditure of $30,000 on a unit of plant used exclusively over 3 years for the purpose of carrying on research and development activities. The aggregate research and development amounts in relation to the company for the 3 years are (say) $60,000 in the first year of use, $40,000 in the second year and $20,000 in the third year.

- In Year 1, the deduction allowable to the company is $15,000 that is, one-third of the qualifying plant expenditure multiplied by the maximum deduction acceleration factor (see earlier notes) of 1.5.

- In Year 2, the deduction acceleration factor applicable to an aggregate research and development amount of $40,000 is 1.4167 (calculated to 4 decimal places). The deduction allowable to the company is therefore $14,167 - one-third of the qualifying plant expenditure multiplied by that factor.

- In Year 3, as the aggregate research and development amount is $20,000, paragraph 73B(15)(b) applies so that only one-third of the qualifying plant expenditure ($10,000) is allowable.

Proposed sub-section 73B(16) facilitates the allowance of increased deductions in the years of income commencing on 1 July 1991 and 1 July 1992 in respect of qualifying plant expenditure incurred by an eligible company in the 1989-90 and 1990-91 years of income (under paragraph 73B(15)(a)) and in respect of adjustments to be made on the disposal, loss or destruction of non-pilot plant (paragraph 73B(23)(e)) or on the disposal, loss or destruction of pilot plant (paragraph 73B(24)(e)). For the purposes of determining the deduction acceleration factor to apply to that expenditure or adjustment, it is necessary to ascertain a notional aggregate research and development amount in relation to the company in relation to the 1991-92 and 1992-93 years of income. This is achieved by treating, under paragraph (a) of sub-section (16), the

reference in the definition of "deduction period" (in sub-section 73B(1)) to 30 June 1991 as a reference to 30 June 1993. Similarly, the reference in sub-section 73B(4) to 1 July 1991 is, by paragraph (b) of sub-section (16), treated as a reference to 1 July 1993.

Another principal operative provision of section 73B is sub-section (17). In terms of that sub-section, one-third of the "qualifying building expenditure" (as determined under sub-section (4)) of an eligible company in a year of income is allowable as an income tax deduction to the company in that year. Unlike the sub-section 73B(14) and (15) deductions previously discussed, the level of deduction allowable under sub-section (17) is not dependent on the level of the aggregate research and development amount for a company for a year of income and no deduction acceleration factor is relevant - although, provided that the building or the extension, alteration or improvement to the building, as the case may be, continues to be used exclusively for research and development activities for 3 years, one-third of the qualifying building expenditure is taken into account in ascertaining the deduction acceleration factor applicable in respect of other relevant expenditure. Subject to the operation of sub-sections 73B(25) to (28) - see later notes on those sub-sections - qualifying building expenditure is written-off in equal instalments over 3 years, commencing with the year in which the building is first used by an eligible company exclusively in research and development activities.

As noted earlier, an eligible company will be able to elect that section 73B not apply to a unit of plant, with the result that other relevant provisions of the Principal Act would be capable of applying. A company might wish to take that course where, for example, the plant is pilot plant costing in excess of $10 million and is, in any event, eligible under sub-section 57AL(4) of the Principal Act for depreciation deductions writing-off the cost over 3 years. By proposed sub-sections 73B(6), (15), (20) and (22) - see the notes on those sub-sections - only the first $10 million of the cost of a unit of pilot plant may be deductible (at an increased rate, if appropriate) in the first 3 years of use exclusively for research and development purposes, although the excess of the cost over $10 million may be deductible under other provisions of the Principal Act after the third year. Where the cost of a unit of pilot plant is significantly more than $10 million, a company may decide that it would be more economically efficacious to forgo the increased deductions under section 73B in the interests of gaining tax deductions in respect of the full cost of the unit of pilot plant from the first year of use. To provide for such situations, it is proposed that a company may, in accordance with sub-section 73B(18), elect that section 73B not apply and, where such an election is so made, then the section does not apply, leaving the way open for the other provisions of the Principal Act to apply to that unit of plant instead.

To be effective, an election under sub-section (18) must, in accordance with proposed sub-section (19), be exercised by written notice and lodged with the Commissioner of Taxation - generally no later than the time of lodgment of the first return of income in which the company would have otherwise made a claim under section 73B in respect of the unit of plant. The Commissioner may, however, allow an election to be made by a later date.

Sub-section (20) is to be included in section 73B for the purpose of ensuring that any expenditure in respect of which deductions have been allowed or may become allowable under that section cannot also be allowed as deductions or taken into account in ascertaining allowable deductions under any other provision of the Principal Act. There are exceptions to that general rule and these are expressed in sub-sections (21) and (22).

The first of these exceptions is contained in proposed sub-section 73B(21), whereby an eligible company is not denied deductions under any other applicable provision of the Principal Act in relation to a unit of plant where, before the end of the third year in which deductions would, otherwise, have been allowable under sub-section (15), that unit of plant is no longer used exclusively for research and development activities but for other purposes in connection with the company's business. As previously discussed in the notes on sub-section (5), where a unit of plant ceases to have exclusive use in the carrying on of research and development activities, the expenditure in acquiring that plant becomes no longer qualifying plant expenditure and no longer eligible for deductions under sub-section (15), nor is it taken into account in determining the aggregate research and development amount in relation to the year in which that exclusive use ceases or any subsequent year. The general application of sub-section (20) would deny deductions that might otherwise be allowable under other sections of the Principal Act in respect of the remainder of the cost of the unit plant not taken into account for deductions under sub-section (15). Accordingly, sub-section (21) permits the application of those other sections.

Sub-section 73B(21), however, also allows for two factors which are relevant in the application of provisions such as the general depreciation provisions, and special deduction provisions such as Division 10 (the general mining provisions). The first of those factors is (under paragraph 73B(21)(a)) the deemed cost of the unit of plant, that being an amount equal to the "written-down value" of the unit of plant. The calculation of the written-down value of a unit of plant is discussed in detail in notes on the definition of that term. The second factor, determined under paragraph 73B(21)(b), is the deemed time of acquisition of the unit of plant for the purposes of the calculation of deductions allowable under other provisions

of the Principal Act. Sub-paragraph (b)(i) relates to cases where the unit of plant was used by the company exclusively for research and development activities on the first day of the year of income in which that use ceased. In such cases, the unit of plant is deemed to have been acquired, for the purposes of those other provisions, on that day. In other cases (under sub-paragraph (b)(ii)), where the unit of plant was first used during a year of income exclusively in research and development activities and during the same year was used for another purpose, the unit of plant is deemed to have been acquired, for the purposes of those other provisions, on the day it commenced to be used for that other purpose.

Where a unit of pilot plant used exclusively for research and development purposes costs in excess of $10 million, by virtue of sub-section 73B(6) - see notes on that sub-section - only the first $10 million of the cost is eligible for the special deductions under sub-section 73B(15). But for sub-section 73B(22), sub-section 73B(20) would prevent the ordinary depreciation provisions of the Principal Act from having any application. However, sub-section (22) allows that, after sub-section (15) has had effect (in respect of 3 years of the plant's exclusive use in research and development activities), those ordinary depreciation provisions may then apply to the excess of the cost over $10 million (that is, the then written-down value of the unit of plant) at the end of the last of those 3 years of income.

Sub-sections (23), (24), (25), (26) and (27) of proposed new section 73B contain provisions which take effect on the disposal, loss or destruction of plant or buildings in respect of which the special deduction provisions of section 73B have applied. Each of the sections are in similar format, in that, where the consideration receivable in respect of the disposal, loss or destruction is less than the "written-down value" of a unit of plant or the "undeducted building expenditure" in the case of a building or an extension, alteration or improvement (see the notes on the definitions of these terms), a deduction is allowable and, where the consideration is more than the written-down value, the company's assessable income includes all or part of that consideration.

The criteria for the application of sub-section 73B(23) to a unit of plant (not being a unit of pilot plant with a cost exceeding $10 million) are:

- that a deduction has been allowed or is allowable in respect of the unit of plant under sub-section 73B(15) (paragraph (a));

- the unit of plant is disposed of, lost or destroyed (paragraph (b));

- before that event, the plant had been used by the company exclusively for research and development purposes (paragraph (c));

- no deduction has been allowed or is allowable under section 54 in respect of that unit of plant (paragraph (d)).

Where those criteria apply and the consideration receivable in respect of the disposal, loss or destruction is less than the written-down value, the amount by which that written-down value exceeds the consideration gives rise to an allowable deduction, increased by the deduction acceleration factor if the aggregate research and development amount in relation to the company in relation to that year of income exceeds $20,000 (paragraph (e)).

On the other hand, if the consideration receivable in respect of the disposal, loss or destruction of the unit of plant exceeds its written-down value, then the excess is included in the company's assessable income for the year of income (paragraph (f)). The amount so included is, however, limited to the difference between the cost of the unit of plant and its written-down value - that is, there is no recovery of any increased (up to 50%) deduction allowed under sub-section 73B(15).

Sub-section 73B(24) applies in respect of units of pilot plant costing in excess of $10 million and the criteria in paragraphs 73B(23)(a) to (d) (discussed in the preceding notes) are also contained in paragraphs 73B(24)(a) to (d) with broadly the same consequences on its disposal, loss or destruction. However, because part of the cost is the "ineligible pilot plant amount" - see earlier discussion of the definition of this term - a slightly different set of rules applies to amounts deductible where the consideration falls below the written-down value of the unit of plant. The first possibility (to which paragraph 73B(24)(e) refers) is that the consideration receivable falls between the written-down value of the plant and its ineligible pilot plant amount. In this case, the deduction allowable is the shortfall of the consideration below the written-down value, increased by the deduction acceleration factor in relation to the company in relation to the year of income. The second possibility is that the consideration receivable in respect of the disposal, loss or destruction of the unit is less than the amount of the ineligible pilot plant amount (paragraph 73B(24)(f)). The amount of the deduction allowable in this case is a composite amount represented by a formula in paragraph (f). In simple terms, the deduction is $5 million for each year in which the deduction has not, for the purposes of sub-section 73B(15), been allowed, out of the total number of 3 years - see earlier notes in relation to sub-section 73B(15) - plus the amount by which the consideration falls short of the ineligible pilot plant

amount. The figure of $5 million used in the formula is a shorthand way of expressing one-third of $10 million (the maximum cost of pilot plant that is, by sub-section (6), eligible for increased deductions under sub-section (15)) increased by the deduction acceleration factor of 1.5. If, however, the consideration receivable in respect of the disposal, loss or destruction of the unit of pilot plant is greater than the written-down value of that unit of plant then, as with paragraph 73B(23)(f), paragraph 73B(24)(g) will include that excess in the company's assessable income, but limited to the difference between the cost of the plant and its written-down value.

Sub-sections 73B(25) and 73B(26) are in almost identical terms in their application to a building, or an extension, alteration or improvement to a building, in respect of which deductions have been allowed under sub-section (17) (paragraph (a) in each sub-section) where that building, extension, alteration or improvement is totally (sub-section (25)) or partly (sub-section (26)) destroyed (paragraph (b)).

Where, under paragraph (c) of each sub-section, there is an amount of "undeducted building expenditure" (as defined in sub-section 73B(1)) in relation to the destroyed property and the amount of the consideration receivable in respect of, or attributable to, the destroyed property is less than that undeducted building expenditure, a deduction of the amount of the difference is allowable to the company in the year the destruction occurred. In the reverse case, where the consideration receivable in respect of, or attributable to, the destroyed property exceeds the amount of the undeducted building expenditure then, under paragraph (d) of sub-section 73B(25) or 73B(26), the amount of that excess, to the extent of the amounts of deductions allowed under sub-section (17) in respect of the building, extension, alteration or improvement, as the case may be, is included in the company's assessable income of the year in which the destruction occurred. Where, however, there is no amount of undeducted building expenditure (that is, after the 3 year deduction period for the purposes of sub-section 73B(17)), the amount of the consideration receivable (to the extent of the deductions allowed under sub-section (17)) is, in accordance with paragraph 73B(25)(e) or 73B(26)(e), included in the company's assessable income for the year in which the destruction or part destruction of the building, or the extension, alteration or improvement to a building, as the case may be, occurred.

Where the provisions of sub-section 73B(26) require that an amount of consideration received upon the destruction of a building be determined as attributable to part of that building or to part of an extension, alteration or improvement to a building, sub-section 73B(36) - discussed below - provides for the Commissioner of Taxation to determine that amount.

Sub-section 73B(27) comes into effect in respect of the sale or other disposal of a building, or of an extension, alteration or improvement to a building, where the expenditure incurred by an eligible company in respect of its acquisition or construction has been fully deducted under sub-section 73B(17) and the sale or disposal occurred after the end of the 5 year period which would bring sub-section (28) into effect (see the following notes on that sub-section). Under paragraph (27)(c), where deductions would have been allowable under Division 10D (which allows for the write-off over 25 years of the cost of buildings constructed for income-producing purposes) if section 73B had not applied, the amount of the consideration (not exceeding the original amount of building expenditure), reduced by the total of the Division 10D deductions that would have been allowable, is included in the company's assessable income in the year of sale or disposal. In cases where Division 10D would not have applied to the building expenditure, then the amount of consideration (to the extent of that building expenditure written-off under sub-section 73B(17)) is included in the company's assessable income of the year of sale or disposal.

Sub-section 73B(28) is a provision designed to safeguard against the exploitation of the 3 year write-off available under sub-section 73B(17) in respect of buildings used exclusively for the carrying on of research and development activities by or on behalf of an eligible company. Where, before the expiry of a period of 5 years from the day when the company commenced to use the building or the extension, alteration or improvement to the building, as the case may be, the company sells, or otherwise disposes of that building, extension, alteration or improvement (sub-paragraph (28)(b)(i)) or ceases to use that building, extension, alteration or improvement, as the case may be, exclusively for research and development activities (sub-paragraph (28)(b)(ii)), the sub-section comes into effect to deny at all times the application of section 73B - other than sub-section 73B(20). As a result, deductions are deemed never to have been allowable in respect of that building, etc., under sub-section 73B(17) and the expenditure incurred by the company in the acquisition or the construction of the relevant building or extension, alteration or improvement is deemed never to have been qualifying building expenditure (that is, it cannot contribute to the calculation of any deduction acceleration factor in the first 3 years of its use). Under the amendment being made by clause 8 to section 170 of the Principal Act, assessments will be able to be re-opened for the purpose of giving effect to sub-section 73B(28).

There will be cases where, although the conditions set down in sub-section 73B(28) for the application of that sub-section are present, it would, nevertheless, be unreasonable for that sub-section to apply. The new section, therefore, allows, in sub-section 73B(29), for

sub-section (28) not to apply where the Commissioner of Taxation, having regard to certain specified matters, is satisfied that it would be unreasonable for it to do so. The matters to which the Commissioner must have regard are -

- the nature of the company's use of the building or of the extension, alteration or improvement, as the case may be, both before and after the disposal or change of use referred to in paragraph (28)(b) - sub-paragraph 73B(29)(b)(i);

- the circumstances which gave rise to the disposal or change of use - sub-paragraph 73B(29)(b)(ii);

- the period during which the company had carried on research and development activities and any period during which it was likely to continue to do so - sub-paragraph 73B(29)(b)(iii);

- other matters relating to the use of the building or the extension, alteration or improvement to the building or relating to the company's other activities, where the Commissioner considers these matters to be relevant in determining the reasonableness of the application of sub-section (28) - sub-paragraph 73B(29)(b)(iv).

The provisions of new sub-section 73B(30) come into force where one of the events mentioned in paragraph 73B(28)(b) has occurred, invoking the application of sub-section (28) and where, in the circumstances, it has not been unreasonable for that section to apply. Although the effect of sub-section (28) is to deny any application of section 73B in relation to the expenditure incurred by the company in the acquisition or construction of the building, or the extension, alteration or improvement to a building, as the case may be, where the expenditure was such, or the company's operations were of a particular kind, that other specified provisions of the Principal Act would have applied to the building, then sub-section (30) operates to restore what would have been the effect of those other provisions. The specific provisions mentioned are section 75B (expenditure on structural improvements for the purpose of conserving or conveying water); section 124JA (expenditure on the construction or purchase of timber mill buildings); Division 10 (general mining buildings); Division 10AAA (facilities for transporting minerals); Division 10AA (buildings used in petroleum mining) and Division 10D (buildings constructed for use in income-producing activities). As a result of the amendment (proposed under clause 8) of section 170 of the Principal Act, the Commissioner of Taxation will be able to re-open assessments to give effect to sub-section 73B(30).

Sub-section 73B(31) contains anti-avoidance provisions designed to counter any attempted exploitation of the new deductions for research and development expenditure by way of inflating any amounts paid by an eligible company in the acquisition or construction of plant, a building, or an extension, alteration or improvement to a building, for use by a company for research and development purposes or any other amounts of expenditure which would qualify as research and development expenditure. The provisions of the sub-section closely follow other provisions in the Principal Act - for example, those contained in section 82KR (expenditure in respect of home insulation). Broadly, sub-section (31) is to apply where, in relation to an amount of expenditure incurred in respect of research and development activities, the Commissioner of Taxation is satisfied that the parties were not dealing with each other at arm's length and the amount sought to be deducted exceeds the amount that would have been incurred had the parties dealt with each other on an arm's length basis. In these circumstances, the sub-section operates to deem the arm's length amount to be the amount paid by the company for the relevant purpose.

Sub-section 73B(32) follows in the same vein as sub-section (31) to counter any attempt to inflate the amount of deduction allowable, or to reduce the amount included in assessable income, of an eligible company (under sub-sections (23) to (27)) where the sale, or other disposal, occurs of a unit of plant or of a building or an extension, alteration or improvement to a building. The sub-section is to apply, broadly, where the Commissioner of Taxation is satisfied that the parties were not dealing with each other at arm's length and the consideration receivable by the company in respect of the sale or disposal is less than the market value of the unit of plant or the building or the extension, alteration or improvement, as the case may be, immediately before the sale or disposal took place. In these circumstances, the sub-section operates to deem that market value to be the consideration receivable in respect of the sale or disposal.

The deductions allowed or allowable under the new section 73B are deemed never to have been allowable if the conditions contained in sub-section 73B(33) relating to the commercial exploitation of the results of the research and development activities funded by the relevant expenditure are not met. For the purpose of the application of sub-section (33), if the Industry Research and Development Board forms the opinion that any of the results of the research and development activities funded by expenditure for which deductions under section 73B have been allowed, and that are capable of commercial exploitation, have been exploited otherwise than on normal commercial terms (paragraph (a)) or in a manner that is not for the benefit of the Australian economy (paragraph (b)), then that Board may give the Commissioner of Taxation a certificate stating

that opinion. In those circumstances, sub-section (33) operates to deny any deductions for that expenditure under section 73B. The power of amendment of assessments that is provided under sub-section 170(10) of the Principal Act is, by virtue of clause 8 of this Bill, to be extended to enable effect to be given to sub-section 73B(33).

A further function is given to the Industry Research and Development Board under sub-section 73B(34) where, for the purposes of making an income tax assessment, the Commissioner of Taxation, by notice in writing to Board, requests a written determination as to whether particular activities carried on by or on behalf of a company were research and development activities. Where such a request in writing is made, the Board is required to comply with the request and the determination made by the Board is binding on the Commissioner (sub-section 73B(35).

Sub-section 73B(36) enables the Commissioner, in cases where it is necessary to determine, for section 73B purposes, the amount of consideration receivable where property is destroyed and part of that property is relevant to the application of sub-sections (23) to (27) of that section, to determine how much of an amount receivable by a company under a policy of insurance or otherwise in respect of the destruction of the property is to be taken to be receivable by the company in respect of the relevant part of the property.

Proposed new sub-section (37) is a safeguarding provision against the substitution of contracts (and equivalent arrangements) entered into before 1 July 1985 in an attempt to gain eligibility for expenditure on a unit of plant or the acquisition of a building to qualify for the special deductions available under section 73B. Broadly, the sub-section applies where (paragraph (a)) an eligible company owned a unit of plant or a building before 1 July 1985, or had contracted before that date to acquire a unit of plant or a building, or had commenced construction of a unit of plant or a building before that date (referred to as "the original unit" or the "original building", as the case may be) and (paragraph (b)), on or after that date, the company entered into a scheme, in pursuance of which it became the owner of the original unit or original building, or an identical or similar unit of plant or building, and (paragraph (c)) the expenditure incurred in those circumstances would otherwise have qualified for deduction under section 73B. Where the Commissioner of Taxation is satisfied that the company entered into that scheme for the purpose of obtaining the benefit of the special deduction provisions for plant and buildings used exclusively for research and development activities, he may under sub-section (37) refuse to apply section 73B to that expenditure.

Sub-section 73B(38) facilitates the operation of sub-section 73B(37) in respect of a unit of plant or a building by treating the construction of the unit or building for the company by another person as an acquisition of the plant or building for the purposes of sub-section 73B(37).

Clause 8 : Amendment of assessments

This clause will amend sub-section (10) of section 170 of the Principal Act, which allows the Commissioner of Taxation to re-open assessments at any time, without the limitations usually applying to the making of amended assessments, where this is necessary to give effect to specified provisions of the Principal Act. Clause 8 of the Bill will insert into sub-section 170(10) references to four sub-sections of new sub-section 73B being introduced by clause 7. This will ensure that the Commissioner will have the necessary authority to give effect to the provisions of sub-sections 73B(8), (28), (30) or (33). Discussion of those provisions is contained in the notes on those sub-sections.

Clause 9 : Transitional

This clause, which will not amend the Principal Act, contains some transitional provisions necessary for the operation of new section 73B being introduced by clause 7 of the Bill.

Sub-clauses (1) and (2) of clause 9 are included to make provision for the registration processes referred to in sub-sections (11) and (12) of section 73B. Prior to the enactment of the Industry Research and Development Act 1986, applications for registration have to be made to the Australian Industrial Research and Development Incentives Board and that Board has registered companies for the purposes of the concession being provided by section 73B. These sub-clauses will treat these interim registration processes as sufficient to satisfy sub-sections 73B(11) and (12).

As the concession will apply to relevant expenditure incurred on and after 1 July 1985 (and before 1 July 1991), sub-clause (3) is necessary to ensure that income tax assessments made before the commencement of the operation of section 73B can be re-opened for the purposes of allowing deductions under that section.