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THE PARLIAMENT OF THE COMMONWEALTH

OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO.4) 1989

SUPPLEMENTARY EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon P J Keating MP)

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INTRODUCTORY NOTE

This supplementary explanatory memorandum explains the two amendments proposed to the Taxation Laws Amendment Bill (No.4) 1989 as introduced into the House of Representatives. The amendments concern amendments to the research and development (R&D) provisions proposed in the Bill.

GENERAL OUTLINE

The first amendment will amend clause 7 of the Bill to clarify the method of calculating the amount of R&D expenditure which is to be taken to have been incurred, and the amount of R&D recoupment or grant which is to be taken to have been received or to which an entitlement has arisen, as the case may be, by a company which is a partner in a partnership of otherwise eligible companies.

The second amendment amends clause 8 of the Bill and will clarify a provision which could unintentionally operate to negate the operation of section 73B of the Principal Act in the period from its commencement on 25 June 1986 to 20 November 1987.

FINANCIAL IMPACT

These amendments are of a clarifying nature and will have no effect on the financial impact of the R&D measures contained in the Taxation Laws Amendment Bill (No.4) 1989.

NOTES ON CLAUSES

The first of the two amendments amends proposed subsection 73B(3A) and introduces 4 additional subparagraphs. New paragraph (3A)(c), will provide that in calculating the deduction allowable to an eligible company in a partnership in respect of R&D expenditure by the partnership, the company is to be taken to have incurred so much of the expenditure as was incurred out of money contributed by the company. In this context money contributed will mean the amount contributed, otherwise than by way of loan, in the year of income and expended in that year. It will also include past contributions which were not expended prior to the beginning of the year of income.

Example:

Company P, company Q and company R enter into partnership to undertake an R&D project. Each contributes $100,000 to the capital of the partnership and, under the partnership agreement, is entitled to an equal share in the partnership profits. In the first year the partnership incurs expenditure on the project of $270,000; each partner

thus has an amount of contribution of $10,000 which has not been utilised. In the second year of the partnership a further contribution is made by each partner - company P subscribes $50,000, company Q $75,000 and company R $25,000 and the total ($150,000) plus the carryover from the previous year ($30,000) is expended by the partnership in that year on the R&D project. For the purposes of each partner's claim for a deduction under section 73B in relation to that second year of income, the amount of expenditure to be taken to have been incurred by each will be the amount carried over and expended plus the amount contributed in the year and expended in that year. Thus, the expenditure incurred by company P will be taken to be $10,000 + $50,000 i.e. $60,000; that incurred by company Q will be taken to be $10,000 + $75,000, i.e., $85,000; and that incurred by company R will be taken to be $10,000 + $25,000, i.e., $35,000.

New paragraph (3A)(d) sets out a formula under which a recoupment or a grant is to be allocated between the partners. Under that formula each partner's share of the amount of recoupment or grant is to be the proportion which the company's contribution to the funds of the partnership (as at the time the recoupment or grant is received or an entitlement to it arises) bears to the total contribution (calculated as at the same time) by all of the partners to those funds.

Example.

A partnership comprises company A, company B and research agency C (a body corporate). Company A had contributed $500,000, company B $350,000 and research agency C $150,000, to the funds of the partnership, at the time a grant of $400,000 was received from a State government authority in respect of expenditure incurred by the partnership on an R&D project. In accordance with the formula -

$$\text{amount of grant} \times \frac{\text{partner's contribution}}{\text{total contribution}},$$

Company A would be entitled to receive $\frac{\$400,000 \times \$500,000}{1,000,000}$ i.e. $200,000;

Company B would be entitled to $\frac{\$400,000 \times 350,000}{1,000,000}$ i.e. $140,000; and

Research agency C would be entitled to $\frac{400,000 \times 150,000}{1,000,000}$ i.e. $60,000.

Each of those amounts would then be dealt with, in the hands of each partner, under proposed section 73C or 73D - refer to the notes on those sections in the explanatory memorandum.

New paragraph (3A)(e) ensures that entitlements under sections 73B, 73C and 73D are not to be taken into account in determining the net income of a partnership or any partnership loss under Division 5 of Part III of the Principal Act. Those entitlements are, as explained, to be directly attributed to each partner.

By new paragraph (3A)(f), sections 73B, 73C and 73D will apply to each partner in a partnership, in relation to the expenditure that is to be taken to have been incurred, or in relation to a recoupment or grant, or entitlement to a recoupment or grant, that is to be taken to have been received by each partner company as if that company had been carrying on the project and activities on its own behalf. Thus, a partner will be taken to have carried out any prerequisite actions, in fact carried out by the partnership, such as commencing or ceasing to use a unit of plant, carrying out of R&D activities, disposal of a unit of plant or sale of a building. Similarly it will be the partners and not the partnership which have to satisfy the threshold requirements inherent in the definition of "deduction acceleration factor" in subsection 73B(1) of the Principal Act - see the explanation of this term at page 21 of the explanatory memorandum.

The second amendment is to clause 8 of the Bill which introduces new sections 73C and 73D that will implement a new tax treatment of R&D expenditure that attracts a grant or recoupment. Under that treatment expenditure incurred before 21 November 1987 in respect of which a grant or recoupment is received or receivable will continue not to be deductible; a deduction will be allowed where expenditure is incurred on or after 21 November 1987 and in relation to which a grant or recoupment is received or an entitlement to a grant or recoupment arises.

One interpretation of new subsection 73C(4) is that, unintentionally, it could operate to negate all claims under section 73B.

The amendment now proposed by amendment (2) will ensure that the section operates as intended. This is achieved by providing that where the relevant expenditure was incurred before 21 November 1987 a deduction is not allowable and is taken never to have been allowable in a situation where section 73C applies to the company. Where proposed section 73C has had no application, deductions would continue to be allowable under the relevant provisions of section 73B.

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