



## Can an R&D entity choose not to claim feedstock input and avoid feedstock adjustments?

### Specific Issue Guidance

#### *Can companies avoid needing to report feedstock adjustments by not registering certain activities and not claiming associated feedstock input expenditure?*

Yes, an entity can choose to not register certain activities in order to not claim feedstock input expenditure and avoid the need to report feedstock adjustments. Expenditure on those unregistered activities may then be claimed under other provisions available to the entity, such as normal deductions.

#### Introduction

When claiming the *R&D Tax Incentive*, a company may be required to make a feedstock adjustment if it supplies or uses products produced in the R&D activities. The adjustment reduces the R&D tax benefit through a calculation that increases assessable income.

The feedstock adjustment applies to expenditure incurred on:

- goods or materials (feedstock inputs) that are transformed or processed during registered R&D activities in producing one or more physical products (feedstock outputs)
- energy input directly into that transformation or processing.

A feedstock adjustment can also apply to amounts claimed for the decline in value of assets used in acquiring or producing feedstock inputs.

The feedstock provisions apply to both registered core R&D activities and supporting R&D activities that transform or process feedstock inputs.

This guidance describes how an eligible entity may avoid having to perform feedstock calculations by not registering certain activities that would require the reporting of feedstock adjustments.

#### Guidance

The operation of the *Income Tax Assessment Act 1997* is such that where an R&D entity<sup>1</sup> has registered R&D activities it generates an entitlement, subject to meeting other conditions in the Act, to claim

the R&D tax offset. This includes activities where the expenditure incurred may be subject to a feedstock adjustment calculation.

Under the *Income Tax Assessment Act 1997*, section 355–715 denies an R&D entity the ability to claim a normal tax deduction where the entity has an entitlement to claim an R&D tax offset in respect of that expenditure. As a result, where an R&D entity has registered certain activities, expenditure on which may give rise to a feedstock adjustment, the entity cannot choose to claim the expenditure under a normal tax deduction<sup>2</sup>. While an activity is registered, the only claims available to an entity for expenditure relating to that activity are those under the *R&D Tax Incentive*.

An R&D entity may decide that claiming the *R&D Tax Incentive* for feedstock amounts is not sufficiently beneficial and they may wish to opt-out. To assist R&D entities, AusIndustry and the ATO have jointly developed the following administrative solution.

In this solution, R&D entities can choose not to register R&D activities or parts of the activities that involve the acquisition or production of goods or materials that are to be transformed or processed in R&D activities.<sup>3</sup>

To do this an R&D entity would include an express statement (see below) in their *R&D Tax Incentive* registration application that the relevant activity does not include the specific actions that would give rise to a requirement to perform a feedstock adjustment calculation. An R&D entity may either choose to make this statement against each of the relevant activities or once in relation to each project.<sup>4</sup>

By doing this an R&D entity does not create an entitlement to claim the R&D tax offset in respect of the expenditure on those acquisition or production activities and, consequently, does not need to

<sup>1</sup> An R&D entity is a company incorporated under Australian law, or a foreign company that is an Australian resident for income purposes, or a foreign company carrying on business through a permanent establishment in Australia (where a double tax agreement is in force between Australia and the resident country).

<sup>2</sup> Unless the registration is varied to remove the activity (including in accordance with a finding of Innovation Australia)

<sup>3</sup> See paragraph 109 and 110 of TR 2013/3 for the ATO view in respect of the operation of 355-715 in these cases

<sup>4</sup> This statement informs both the ATO and AusIndustry that the transformation or processing activity to be registered does not include the action of acquiring or producing the feedstock inputs.

calculate and report a subsequent feedstock adjustment with respect to that expenditure. The R&D entity may then consider claiming the expenditure it has excluded from the *R&D Tax Incentive* provisions under other tax law provisions.

It should be noted that other expenditure on R&D activities that meets the requirements for entitlement to an R&D tax offset but does not fall within the criteria below can still be claimed as an R&D tax offset:

- expenditure on goods or materials (feedstock inputs) that are transformed or processed during registered R&D activities in producing one or more tangible products (feedstock outputs)
- expenditure on energy input directly into that transformation or processing.
- amounts claimed for the decline in value of assets used in acquiring or producing feedstock inputs.<sup>5</sup>

It is a matter for the R&D entity as to whether it will or will not register the parts of its activities that would require the reporting of a feedstock adjustment. R&D entities should consider the issues and potential consequences carefully before making any decisions in this regard. In some cases, such as where an entity claims the refundable R&D tax offset, the additional benefit the entity receives by undertaking the adjustment calculation may outweigh the compliance cost of performing the calculation.

It should be noted that while feedstock related activities may, depending on the circumstances, be core or supporting R&D activities there may be issues for R&D entities that choose to not register parts of the activities that would be a core R&D activity. Potential consequences of not registering parts of the core R&D activities include:

- R&D entities may not be able to register and claim a supporting R&D activity that is directly related only to unregistered parts of the core R&D activities [see subsection 27A(3) of the *Industry Research and Development Act 1986*].
- R&D entities will not be able to rely upon the unregistered parts of the core R&D activities for any supporting R&D activities in relation to any findings [see subparagraphs 27B(1)(c)(ii), 27J(1)(c)(i)-(iv), subsection 28A(b) and paragraph 28A(c)(ii) of the *Industry Research and Development Act 1986*].
- R&D entities should also consider the potential effects that not registering parts of the core R&D activities may have on any overseas finding applications such as:
  - where an overseas-based activity relies on having a significant scientific link with that activity [see subsection 28D(2) of the *Industry Research and Development Act 1986*]; or,
  - where the expenditure on the unregistered Australian core R&D activity and related Australian supporting R&D activities would be required to meet the overseas finding expenditure criteria [see subsection 28D(5) of the *Industry Research and Development Act 1986*].

<sup>5</sup> The ATO has provided extensive guidance on the nature of expenditure that would meet the requirements and give rise to a feedstock adjustment in TR 2013/3

Where an R&D entity decides not to register parts of the activities that may give rise to a feedstock input claim and feedstock adjustment it should report this explicitly in its registration application. This should be done by using the following wording:

*'Regardless of any express or implied indications to the contrary, the activity/activities for which registration is sought does/do not include:*

- *the acquisition or production of goods or materials transformed or processed in producing one or more tangible products*
- *the acquisition of energy that is input directly into the transformation or processing, or*
- *the use of assets in acquiring or producing the feedstock inputs.'*

The words can be entered once for each Project in the Project Objectives Field or for each individual activity in the registration application form.

The R&D entity should enter '0' when asked to report its feedstock input expenditure in the *R&D Tax Incentive* registration application if it has chosen to adopt the above administrative solution for all relevant activities.

The effect of the omission will be that the R&D activities that give rise to a feedstock adjustment will not be registered and therefore the entity is not entitled to claim the R&D tax offset in respect of expenditure on those activities.<sup>6</sup> This enables the entity to opt out of the feedstock adjustment calculation and, if carrying on a business<sup>7</sup>, would be entitled to a general business deduction for the expenditure. As a result, no *R&D Tax Incentive* notional deduction will be available for this expenditure.

- For further details concerning feedstock adjustments, see the information available on the [ATO website](#).
- For a more thorough analysis of the feedstock provisions, see [Taxation Ruling 2013/3](#).

This document is intended to provide useful information for companies considering accessing the *R&D Tax Incentive*. However it is not exhaustive and it is not legal or financial advice. It is your responsibility, with the assistance of any advice you wish to seek, to satisfy yourself about the eligibility of your activities for the *R&D Tax Incentive*. The Commonwealth disclaims all liability for any loss or damage arising from you or anyone else relying on this document or any statement contained in it.

<sup>6</sup> Note expenditure on other (registered) activities would continue to be claimable

<sup>7</sup> Consideration may need to be given when determining whether to choose not to register the R&D activities where the R&D entity is not carrying on a business as this will impact the ability to claim a deduction in relation to that expenditure under other provisions of the *Income Tax Assessment Act 1997*.