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Board of Taxation Secretariat
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Via email: RandD@taxboard.gov.au

15 September 2021

Dear Board members

RE: Submissions and Comments on the Review of R&D Tax Incentive Dual-Agency Administration Model to The Board of Taxation (Board)

BDO is pleased to provide this submission in response to the Board's request for contributions to its review of the dual-agency administration of the R&D Tax Incentive (R&DTI) programme.

We understand that the objective of this review is to examine the effectiveness of the dual administration of the R&DTI by Industry Innovation and Science Australia (IISA) for the Department of Industry, Science, Energy and Resources (Industry), and the Australian Taxation Office (ATO). Further, the Board proposes to examine whether the roles and responsibilities of the ATO and IISA/DISER are efficient, distinct and clearly understood.

As an external service provider servicing over 450 claimants of the R&DTI in Australia, and with regular interaction within the BDO Global network of R&D administration models used in comparative jurisdictions, BDO is well positioned to provide comment and insight based on our experience with the program and working with both agencies in question.

We trust our submission is of assistance and would be happy to discuss further.

Yours Sincerely

Nicola Purser
Partner

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Introduction

We welcome the opportunity for the Board to consult with stakeholders like BDO in their review and evaluation of the dual agency model of the R&D Tax Incentive (R&DTI). As a program delivered through the tax system, the R&DTI should inherently be based on self-assessment with a compliance framework that involves resources with the experience to assess the eligibility of both the R&D tax offsets, in accordance with a complex tax system, and resources that have the industry experience to assess the eligibility of the registered R&D activities. This requirement for dual assessment is the reason Parliament created the dual agency administrative framework to be jointly administered by the Australian Taxation Office (ATO) and Industry Innovation and Science Australia (IISA) and the Department of Industry Science Energy and Resources (Industry). One of the natural advantages that a dual-agency model should present, is the opportunity for one agency (IISA) to engage directly with industry to promote the program, as opposed to a single agency model in which that agency has an overarching role to recover or protect tax revenue.

BDO is fully supportive of both the administering bodies' roles in maintaining the integrity and compliance of the R&DTI programme. In our view it makes sense for both agencies to be involved in administering the R&DTI. Further, the delineation between each agencies role is clear to claimants and their advisers, and to the agencies themselves. In our view, where shortcomings in the operation of the dual agency administration have arisen, the major cause of the difficulties that have arisen is through the actions of agency staff that may not have been adequately educated or trained as to their role, or whose lack of knowledge or sufficient experience has been a significant contributor to any issues experienced. Generally, when we are dealing with officers that are senior or experienced, it is obvious that they have sufficient know how to address the specific matters that are the responsibility of the agency for whom they work, and do so in a very professional manner.

As highlighted in our response to the Australian National Audit Office (ANAO) performance audit of the administration of the R&DTI, there have been some instances where the dual agency framework can appear, on occasion, frustrating, inconsistent, resource demanding and lacking appropriate communication channels. BDO provides the below commentary and examples where the current dual agency administration model exacerbates shortcomings, and has provided suggestions to improve the dual agency model to better align performance with the overall object of the R&DTI legislation, being the encouragement of industry research and development.

It is BDO's view that with appropriate additional training and education of officers from both agencies there would be a resulting reduction of duplication between the two administrators, simplified administrative processes, to reduce the compliance costs for applicants or adverse outcomes that were highlighted in the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) report from December 2019[1]. We endorse and would extend the majority of recommendations from that report to all businesses, regardless of size. In particular:

- ATO and IISA/DISER's administration of the R&DTI should reflect the clear delineation between the responsibilities of each agency, but with an enhanced level of officer know how of the scheme, both agencies would be in a position to provide a seamlessly integrated service encompassing the understanding and interpretation by both the ATO and IISA/DISER as to the operation of the law in,

[1] Australian Small Business and Family Enterprise Ombudsman, *Review of the R&D Tax Incentive* (Report, December 2019).

and their approaches to, compliance needs. This would provide a more consistent and practical support for an industry based incentive that aims to encourage the undertaking of R&D

- The joint ATO and IISA/DISER guidance material must also be provided, maintained and updated to reflect current legislative interpretation, including updating to reflect recent case law. To this point, BDO would recommend creating a combined guidance such as revisiting the Guide to the R&D Tax Concession Parts A, B and C
- BDO endorses the approach to compliance being proactive, professional, collaborative and proportionate to the size of the claim and industry
- Most importantly, both IISA/DISER and the ATO need to invest in ensuring that client-facing staff are suitably trained to ensure information, advice and decision-making is more uniformly consistent with the terms of the relevant legislation
- Specialist compliance teams drawn from experienced both IISA/DISER and ATO officers should be available to short circuit certain contentious matters arising from compliance activity.

Current administration model

1. Do you consider that the roles and responsibilities of the two administrators (ATO and IISA/DISER) are distinct and clearly understood? If not, how might they be enhanced?

Read as a whole, the legislative scheme across the IRD Act and the *Income Tax Assessment Act 1997* provides for separate and distinct decision making roles for the IISA and the ATO and is proscriptively detailed in setting out how the roles of the IISA/DISER and ATO interact. Under this legislation only the IISA has the power to make findings or decisions as to whether particular activities are R&D activities, and only the ATO can determine whether expenditure was incurred on one or more registered R&D activities.

As an industry based tax incentive, it should be expected that each agency would approach their roles and responsibilities in the administration of the R&DTI in line with the object as outlined in 355-5 of the ITAA – to encourage industry to conduct R&D activities. However, as highlighted in the 2019 ASBFEO report, many claimants have encountered issues with how one or both agencies had performed their administrative duties. In more recent times, perhaps as a result of the ASBFEO report, BDO has seen a more supportive framework for claimants of the R&DTI being adopted by both agencies, although there are still some examples of 'overreach' by the ATO of the IISA's role and responsibility to make assessments of activity eligibility.

The IISA/DISER's role and responsibilities are clearly understood through easily accessible guidance on the program regularly published by AusIndustry, a division of DISER. Notwithstanding the often inconsistent messaging and lack of industry application examples included in this historical guidance material, most of this guidance clearly focuses on the eligibility of activities for the R&DTI, making it clear to readers that activity eligibility is the domain of AusIndustry. Axiomatically, expenditure eligibility relating to the activity subject to the R&D Tax Offset, is clearly the domain of the ATO.

More recently, AusIndustry has appeared to broaden its interpretation of eligibility under the R&DTI programme to be more in line with recent case law interpretations contrary to IISA/DISER's fundamental activity interpretive framework. Further, IISA/DISER's recent changes to its compliance framework has

improved engagement with industry to take into account the eligibility risk of an applicant and the applicant's behaviour to appropriately categorise compliance risk.

Unfortunately, in contrast to the ATO's stated compliance review objectives -that its role is not to assess eligibility of activities, there have been instances where this stated approach has not been put into practice, usually by officers whose know-how and experience appear limited. We have seen ATO 'Requests For Information that question how the claimed expense was on an activity that met the activity eligibility criteria. Whilst the ATO has the opportunity to refer concerns of activity eligibility to AusIndustry, in our experience it does this reluctantly.

We note that the ATO position towards making assessments on activity eligibility may have been reinforced by a recent comment by Justice Thawley in the Federal court decision *FCT vs Auctus Resources Pty Ltd*[2] whereby he suggested the Commissioner has the ability to form his own view on the eligibility of R&D activities in situations where there are no Findings on activity eligibility. In BDO's view, any situation in which the ATO can make determinations on activity eligibility is deeply concerning, not only because of the lack of experience of ATO officers to make such decisions, but taking such a position would undermine Parliament's intention of a successful dual agency model that encourages R&D.

In order to ensure that the roles and responsibilities of both agencies is clearly understood and integrity of the R&D Tax Incentive program is maintained, BDO would recommend:

- Further clarification within the ATO compliance framework that any assessment of activity eligibility needs to be done by IISA through the appropriate Finding process
- The use of more efficient processes and use of resources in both agencies that understand how industry operates. Whilst such attributes are often present amongst the senior officer ranks, the customer facing staff often have little industry experience and training on how to administer an industry based incentive program. On-going investment is required to bolster the corporate know-how to a level enabling more effective decision making processes to be applied in an expeditious and transparent manner
- For matters of high concern or urgency, matters should be referred to a specialist compliance team that is comprised of both AusIndustry and ATO officers with significant industry/commercial experience as well as technical experience in administration of the R&DTI. Such an approach may help diffuse some of the misunderstanding of each agencies role and provide certainty to claimants of activity and expenditure eligibility. The specialist team must be able to be requested by the applicant at any time following the initiation of a compliance review.

[2] *Commissioner of Taxation v Auctus Resources Pty Ltd* [2021] FCAFC 39

Dealings with the current administration model

2. From your experiences, are there any aspects of the current registration, eligibility review and compliance arrangements which impede or hinder your dealings with the current administration system? What works well?

BDO's experience is that there is a distinct difference in the approach taken by both agencies towards administration of the program. The IISA/DISER through AusIndustry is regularly trying to improve the customer experience through improvements to its guidance materials, registration and compliance review processes, particularly following from the outcome of the ASBFEO report. Furthermore AusIndustry often consults with industry before releasing much of its guidance material.

BDO's experience is that the change to AusIndustry's compliance framework to take into account the eligibility risk of an applicant, and engaging directly with R&D claimants under review as a result of this new compliance, is working well. While BDO commends AusIndustry for adopting these processes and guidance, its historical approaches have, nevertheless, created a legacy of uncertainty and confusion within the R&DTI programme. There are still elements which we describe below that we believe impede and hinder dealings within the administration system and may deter companies conducting legitimate R&D activity from claiming the R&DTI, including:

- The activity registration process. Whilst we commend Industry from moving away from the PDF smart form and moving to an online portal, as a program based on self-assessment, the new application form and associated guidance is considered overly prescriptive, cumbersome and adds significant compliance burden to applicants. It adopts a restricted interpretation of the legislative provisions that has not been supported in recent administrative and judicial reviews of the legislative provisions. In particular, it is considered that AusIndustry's interpretation needs to reflect recent decisions that point to a very literal application of the legislative terms and an acknowledgement of the incentive as an industry based initiative
- Use of terminology in guidance materials not consistent with the legislation and recent judicial decisions. For example the use of 'business as usual' and 'competent professional'
- The increasing reference to record-keeping requirements which gives the perception of an increased compliance burden to meet the eligibility criteria. The recent PKWK vs ISA[3] case noted that in a commercial setting, the level of record-keeping would not be as detailed or comprehensive as might be found in another institution or university
- The lack of realistic examples of types of projects and activities that could and couldn't qualify in industries such as manufacturing and software
- The experience, qualifications and testimony of the company's internal experts are often not considered by AusIndustry. We have seen numerous examples of assessors referring to external sources, such as blogs, as evidence that knowledge already exists without understanding the context. Third party industry experts should be consulted and, where necessary, used as an intermediary to ensure the evidence presented is well understood
- Eligibility of activity review timeframes. We have often encountered 10-12 month review timeframes for Advanced Overseas Findings, including for biotechnology companies where the need to undertake overseas activities has clearly been established

[3] *PKWK and Innovation and Science Australia (Taxation)* [2021] AATA 706 (24 March 2021)

- Limited interagency communication. One common example is where a company has a substituted accounting period (SAP). AusIndustry's registration team's practice is to contact the claimant's nominated contact requesting a copy of the original letter from the ATO approving the SAP, which may be some years old. It is unclear why this sort of information can't be requested directly by AusIndustry from the ATO.

In contrast, the ATO has done little since the commencement of the program to provide meaningful guidance to claimants, particularly in this complex area of taxation law. What worked well at the outset of the R&DTI program was an approach to compliance consistent with that undertaken under the previous R&D Tax Concession. Initial guidance published by the ATO on their web-site aligned with the R&D Tax Concession, particularly with respect to apportionment of overheads which provided claimants with some certainty as to the compliance requirements. The fact that the ATO has removed this guidance on apportionment and not provided any further guidance matter is reflective of how many view the ATO approach to compliance. Whilst we understand this guidance has been in the drafting phase for a number of years, reviews and audits are being finalised on the basis of an individual officer's or team's position on what is a reasonable apportionment methodology. As a result, claimants are subjected to a greater level of uncertainty than is necessary in regards to complex provisions of the law.

Presumably, due to the generous benefits afforded to R&D applicants under the R&DTI program, the ATO appears to approach R&D taxpayers with a higher threshold of evidence/ substantiation required than for non-R&D related issues. Whether that is holding R&D tax payers to a higher standard of proof or holding preconceived views on an entire industry's eligibility is uncertain, though it is an issue that should be considered. ATO compliance reviews are resource intensive and stressful for claimants as the ATO often start with the position that the offset is overstated. This is often amplified by the lack of understanding by review officers of the practicalities of how industry conducts R&D in a commercial environment. We note, the ATO's skepticism and willingness to disparately treat R&D taxpayers is in direct contrast to the object of the R&DTI program. BDO has experienced instances of compliance reviews that are considered either unreasonable and heavy-handed, or hold the R&D taxpayer to a higher standard of proof than what is normally required under section 262A of the ITAA 1936. Specifically, instances of the ATO's expectation that timesheets are the only means to substantiate claimed R&D salaries or the ATO's indifference to oral evidence have been experienced. This includes instances where the ATO's level of scrutiny is disproportionate to the value of the queried R&D expenses.

We highlight below some elements of the ATO's approach that we believe impede companies conducting legitimate R&D activity from claiming the R&DTI:

- Reliance on terminology in Taxpayer Alerts 2017/3 – 2017/5[4]. These taxpayer alerts use the term 'ordinary business activities', a term not used in the legislation nor recent judicial decisions. Furthermore ATO officers take the view that ordinary business activities cannot be R&D activities, seemingly unaware of the paradox this creates for R&D intensive companies
- The view that record-keeping requirements are greater than that of other elements of managing tax affairs. In particular a common expectation for claimants to substantiate salary time is timesheets or contemporaneous records that clearly show the time spent on R&D activity vs non-R&D activity. This fails to recognise that timesheets are themselves a method of estimation, and by staff that are likely not they are not aware at the time of conducting the activity as to whether it will be registered

[4] ATO. Taxpayer Alert TA 2017/3., Taxpayer Alert 2017/4., Taxpayer Alert 2017/5.

after the end of the financial year as an eligible activity. Furthermore, finance staff that allocate expenses to internal costing systems cannot be expected to know whether the invoices/coding systems relate to future registered R&D activities

- The lack of clear guidance materials on technical manners published in a timely manner. For example the ATO released a draft TD in July 2020 regarding the interaction between the R&DTI and JobKeeper payments which, following an invitation to provide comments by August 2020, is still under development. Specific guidance on building and feedstock in agriculture is still to be released
- Limited interagency communication – as noted above.

In our view, an improved administration model would see guidance material be released by both agencies in consultation with industry. For example examples of activities that could qualify and the types of expenditure that was included in the claim for a particular industry.

3. Have you experienced any difference in the way the program has been administered in response to previous reviews? We would like to hear what has been improved and/or any additional challenges that have been experienced.

It is our experience that AusIndustry has improved its approach to compliance following the ASBFEO report. The main positive change encountered is the improved compliance framework implemented including meeting with companies under review. It is our experience that meeting with companies, even if by virtual means, allows both parties to understand and address concerns leading to a more efficient and effective process. We have also seen recent evidence of AusIndustry prioritising the review and completion of Advanced Overseas Findings.

The main additional challenges for claimants with respect to the roles and responsibilities of AusIndustry is the confusion and concerns that the new registration form produces. For example, the form requires companies to advise whether they have documentation that goes above what is required by law. It is unclear what repercussions may arise if a company believes it has documentation that is later found to be inadequate in the eyes of the administrators. In addition the form raises concerns with eligibility if you are in certain industries such as software and manufacturing industries.

In our experience there has been only a slight improvement in the approach taken by the ATO following the ASBFEO report, with occasional requests for information able to resolved more quickly than prior to the ASBFEO report. However more often than not, claimants undergoing ATO compliance activity are still seeing requests for information that are excessive and out of kilter with the size of the claim and how industry actually conducts and records R&D activity. Examples of additional challenges experienced by claimants when it comes to compliance activity by the ATO include:

- A renewed focus on timesheets as the only acceptable evidence of staff time on R&D activities (as noted above)
- Taking a position that previous pre-issue reviews which had last seen correspondence about 15 months prior were still open/unresolved
- An ever-changing landscape of what constitutes a ‘reasonable method of apportionment’
- Expectations that all activities for which expenditure to be claimed on must be detailed in the activity registration

- Proving that the claimed expenditure was on the registered R&D activities. For example an expectation that third party invoices should describe the services undertaken that relate to the registered activities
- A consistent interpretation that documentation to support the claim must have been contemporaneous despite the recent Commissioner of Taxation v Bogiatto[5] case
- Lack of timely guidance material on technical matters (such a treatment of jobkeeper expenditure under the R&D provisions, treatment of the instant asset write/off etc.).

Most of these issues relate to a consistent internal viewpoint that there is a greater compliance burden for claimants of the R&DTI than other tax affairs. This view is highlighted by the ATO's draft decision impact statement on the impact of the *Commissioner of Taxation v Bogiatto*[6] case in which the ATO's states it's position that these views are specifically directed to the discharge of the onus of proof in applications made by the Commissioner under the promoter penalty laws, and have no relevance to the onus of proof that is on a taxpayer to establish that an assessment is excessive in a review.

4. What is the cost to businesses in claiming the R&DTI? Where have businesses encountered complexity in the process?

For many claimants, the inconsistent messaging, additional complexities and lack of clarity provided by both regulators leads them to either:

- Seek the services of specialist R&D consultants to help prepare their claim, adding additional compliance costs to the claim process
- Make claims that are at a high risk of non-compliance
- Avoid claiming or investing in R&D activity in Australia.

In our experience the increasing compliance costs to access the R&DTI is primarily driven by a number of factors including:

- Inconsistent guidance material produced by IISA. Despite the definition of eligible R&D activities not changing since the introduction of the R&D Tax Incentive, the interpretation of what constitutes an eligible activity has been constantly changing in guidance material. For example many elements of the software development process were deemed to be ineligible core activities, however current guidance has now included them as part of the experimental process of a core activity
- Lack of appropriate and timely guidance from the ATO. For example there is no clear guidance on the treatment of expenditure incurred under the various instant asset write off schemes, despite the instant asset write off being introduced several years ago
- The inconsistent messages about record keeping requirements and expectation that companies conducting R&D activity should document each step of the experimental process contemporaneously, including allocating expenses to the activity. This fails to recognise the commercial reality of R&D activity conducted in industry, which is distinct from academic research activity. The recent PKWK case[7] highlighted that the courts can accept, that in a commercial setting,

[5] *Commissioner of Taxation v Auctus Resources Pty Ltd* [2021] FCAFC 39
[6] Ibid
[7] *PKWK v Innovation and Science Australia (Taxation)* [2021] AATA 706

the level of record-keeping would not be as detailed or comprehensive as might be found in another institution or university. Whilst it is good practice to document most of your R&D activity, the increasing expectation of supporting documentation by the administrators fails to recognise that businesses are commercially orientated and so have a different approach to projects than academia

- An expectation by the ATO for claimants to break down expenses common with non-R&D activities to specifically identify on a line by line basis expenses incurred on the R&D activities. Under the previous R&D Tax Concession program, the ATO 's PART C: Guide to the Tax Concession provided accepted methods of apportionment which were generally accepted as an effective way of minimising the administrative burden associated with having to go through costs line by line
- The new registration form and claim process requires additional time to prepare, and creates unnecessary warnings about the compliance burden. This is primarily due to the repetitive nature of some sections (a results and conclusion section for each core activity), character limitations, setting up of authorisation, and inability of technical staff to access the online form
- Compliance reviews. Any approach requiring a written response to a multitude of questions is time consuming and costly, particularly if a R&D consultant is required to assist due to the time required to address a large number of questions. This is not helped by the lack of industry understanding by assessors or the changing of assessors which can also significantly delay the process. We are aware of some companies that have successfully defended all of their R&D claim but the negative experience from the approach taken by the regulators and the effort required to defend their claims has put them off making further claims despite continuing to undertake R&D activity.

5. Would you provide any real-life examples of businesses that have recently navigated the R&DTI application process? Were there issues, challenges or frustrations encountered in the process?

In our experience the vast majority of clients that use R&D consultants are able to successfully navigate the R&DTI application process. Whilst some companies are able to navigate the application process themselves, it is our experience that most self-prepared claims are at risk of non-compliance in some aspect of their claim due to a misunderstanding of the scope of eligibility and guidance material.

The new R&D Application form has created several issues for some businesses, particularly large businesses with many projects. We understand that some of these issues are teething issues, but the roll out of the new form without providing claimants the option to still utilise the previous smart PDF form is perhaps a poor decision in light of the technical issues often encountered leading to frustration for those businesses.

Another example of a company frustrated by the current administration landscape is a company that successfully pivoted to help address the COVID-19 pandemic. Not only did the company wait 12 months to receive an approved Overseas Finding from AusIndustry, the R&D tax offset refund is currently being held by the ATO whilst it performs compliance checks. The request for information from the ATO requested that the applicant identify the core or supporting activity the expenditure was incurred on, despite the fact the company has more than 70-activities, does not use R&D activities as their internal costing system, and incurs numerous expenses such as invoices from contractors that relate to several core and supporting activities. The ironic element to this situation is that due to the excessive time periods of the administration of their 2020 R&D claim, the U.S. government has provided significant

funding to the company, helping it set-up and implement overseas manufacturing operations. Whilst we agree that the integrity of the R&DTI must be upheld, we believe the over compliance burden and lack of commerciality in the approach undertaken by both regulators is more likely to encourage businesses to move their R&D activities or entire business off-shore.

A further concerning issue we have encountered in dealing with the ATO is a position in which all expenditure on registered activities is denied because it could not be discerned under review that the expenditure was incurred on the registered activities. In one recent example, the ATO officers involved in an audit of a SME with several patents, and no income, stated that the supporting documentation provided was too technical to confirm that the expenditure was incurred on eligible registered R&D activities. This position was still maintained even after the company had a positive Finding from IISA. R&D activity by its very nature would be expected to be highly technical as such activity is often undertaken by scientists and engineers with different skillsets to ATO officers. We fear that such a position will become even more exasperated by the new R&D Application form due to character limitations which will limit the scope of activity able to be registered.

We have attached in the appendix examples included in our submission to ANAO regarding two recent compliance reviews that were frustrating for claimants of the R&DTI.

6. Does the current administrative process impact the decision to apply for the R&DTI? How has it affected the decision to apply?

The overarching viewpoint of claimants of the R&DTI is that the administrative process and perception of an increased compliance burden required to make a R&D claim is affecting the decision for many to apply. In particular, SME's and companies with R&D expenditure less than $100K must seriously consider the net tax benefit against the cost to making a R&D claim. One of the failings of the administrators in this regard is that due to the nature of the refundable offset on the franking account, the refundable tax offset merely provides a timing benefit, allowing companies to access cash to help fund their R&D activity. We are aware of several companies that feel that the increasing complexity and compliance burden makes claiming not worth pursuing.

This position is enhanced by situations in which the company has undergone a long compliance review by either AusIndustry or the ATO. In such situations the companies have typically experienced an approach that falls short of the object of encouraging R&D activity, whereby the agency has requested more and more information and often have come to their own pre-conceived interpretations of eligibility without fully understanding the context of industry R&D. In particular we note, the ATO's scepticism and willingness to disparately treat R&D tax payers similar to other tax payers is in direct contrast to the object of the R&DTI programme. The ATO experience with company B outlined in Appendix B has resulted in them not making any R&D claims since the ATO audit process began, despite receiving a positive finding on the activities from AusIndustry and the whole claim being accepted by the ATO.

7. How easy or otherwise have applicants found the Advanced Findings process and the Overseas Findings process with DISER?

In our experience, the Advanced Finding and Overseas Finding process is cumbersome, resource intensive, and slow. However, given Findings are binding on the Commissioner, and cover the life of the activities in the Findings, BDO agree that there should be a much greater level of scrutiny placed on Finding submissions than the standard R&D registration process. In general we have encountered:

- Slow response times. We have had several clients receive their Finding approval 12 months after submission. This can be problematic for companies that rely on the refundable offset or have sought confirmation of eligibility to secure investors
- Inconsistency in the approach to the review process between different IISA offices, and in several instances lacking commerciality. For example, in one recent case, despite evidence from experts in the field stating that the technological capability was not available in Australia, the IISA referenced a different technological capability used here and requested evidence why that was not suitable to be used rather than accepting the advice of experts
- The online form is cumbersome to work with and not intuitive. For example it is unclear what information the question is after, and changes to one part of the form can inadvertently change other parts. Some questions such as the expenditure based questions would be best presented in a table format than via the form.

Whilst we generally agree with the Advanced Finding application process, improvements could be made to make the form more efficient and intuitive to use, such as having the activity expenditure and dates provided in a separate table attachment. Furthermore, a meeting (including via on-line platforms) with the applicant at the outset of the review to help clarify the R&D activities included in the Finding will help improve efficiencies with the Finding process.

Improvements and efficiencies

8. What changes could be made to simplify the administrative and compliance obligations for taxpayers, whilst maintaining the integrity of the program?

In order to maintain the integrity of the program whilst ensuring a positive perception by industry we believe the approach to compliance should be proactive, professional, collaborative and proportionate. Whilst we have seen a move towards this approach by AusIndustry, many of the client facing staff in both agencies have little industry/commercial experience. Both AusIndustry and the ATO need to invest in ensuring that client-facing staff are suitably trained to ensure information, advice and decision-making is more consistent with the terms of the relevant legislation and the program being an industry based incentive program.

Key changes that we believe would simplify the administrative and compliance obligations include:

- Recognition by both agencies of the concept of an "R&D project" that is made up of both eligible core and supporting activities and therefore making the arbitrary breakup of expenditure to each activity redundant. The mosaicking of activities or expenses by both agencies under compliance activity fails to recognise that the language used throughout Division 355 is 'activities' and 'expenditure' not 'activity' or 'expense'
- Improve the R&D registration process by simplifying the R&D Application, making the form easier to use, reflective of industry R&D and less repetitive. For example the creation of new knowledge should be at the R&D project not activity level
- Have systems in place to ensure that if AusIndustry has concerns over eligibility of activities, but not so significant as to deny registration, that these be immediately raised and addressed with the company rather than waiting for lodgement of a subsequent registration
- A meeting or video conference should be held with the company at the outset of any compliance review process
- Adopting a safe harbour for apportionment like that used in other jurisdictions (refer response to question 11). Since the ATO regularly raise that one of their main concerns is the apportionment of expenses to the R&D activities, yet do not have any reliable guidance on the matter, we would strongly recommend that companies be entitled to choose a safe harbour rate of apportionment for overhead type expenses. This would also safe claimants excessive time on trying to split expenses on a line by line basis to the activities
- Similar to having a safe harbour for apportionment, a safe harbour for staff without timesheets or other direct time recording methods. Safe harbours could be based upon roles within the company, apportionments based on number of R&D employees, R&D products vs existing products etc. As noted in response to question 11, there are a number 'substantially all' rules used in other jurisdictions
- Adopting administrative and compliance approaches akin to other jurisdictions where claimants have numerous projects, only details of the main projects in terms of expenditure are required to be registered/reviewed
- Adopting a safe harbour for patent generating activities and expenditure. In particular we have seen the ATO take the position that patents generated in the year are not evidence that the company incurred expenditure on eligible R&D activities. The bar for innovation in patenting is much higher than under the R&DTI excessive compliance.

9. What opportunities can you identify to reduce duplication between the two administrators?

As noted above, in our response to question 1, the main area of duplication encountered is the ATO's analysis of expenditure being incurred on one or more registered activities. We have seen numerous instances in which companies with no IISA Finding being asked to provide evidence of how the claimed expenditure is on activities that contribute to the generation of new knowledge. Even when companies have received a favourable finding from IISA in respect of certain activities, we have seen the offset has been held up by the ATO because it is not clear to the ATO reviewers of the link between the expenditure incurred and the activities undertaken.

As has been highlighted previously, we believe that duplication can be avoided through a number of measures including:

- The use of resources in both agencies that are trained in understanding the legislation, case law and understand the practicalities of how industry operate to ensure information, advice and decision-making is more consistent with the terms of the relevant legislation
- The ATO should adopt a compliance/risk matrix similar to that recently adopted by AusIndustry in 2019, that treats taxpayers that are trying to do the right thing in this complex area of tax law with respect. This would enable the ATO to adapt their responses to meet the R&D taxpayer categorised compliance risk, providing tailored compliance guidance for companies who are attempting to follow the R&DTI legislation. A categorised approach to compliance reviews would be a welcomed introduction to the R&DTI programme. Furthermore the risk matrix should ensure concerns over the eligibility of activities should be referred to AusIndustry. Clarification should also be made that activity eligibility is the sole domain of AusIndustry
- A specialist compliance team comprised of both AusIndustry and ATO officers with significant industry/commercial experience as well as technical experience in administration of the R&DTI should be available to claimants
- Institution of a rapid first claimant review programme to work with new claimants so as to highlight any issues for review and provide the ATO/Ausindustry with an early intervention avenue to obviate the need for multiple year clawbacks and amended assessments being pursued where there was a genuine attempt to comply with the law

10. Reflecting on recent updates to guidance provided by the administrators, we would like to hear about its effectiveness/usefulness. What improvements could be made (if any)?

The IISA has taken an active role in providing regular guidance on the R&D Tax Incentive and BDO commends this approach. Specific examples of guidance released over the last 12 months include an updated Guide to Interpretation and software guidance material. Both updates are more in line with the law than their prior iterations. One such example being a more legislatively accurate and less confined description of what constitutes new knowledge in the Guide to Interpretation. However, through the history of the programme, the alignment of such guidance regularly has included some inconsistency with how the courts have interpreted the law, and examples in the guidance tend to be somewhat academic for a program that is intended to be accessed by industry. Accordingly the shortcomings of previous attempts were in our view a significant contributor, (though by no means the only contributor), to widespread uncertainty amongst industry participants as to the applicability of the R&DTI to their industry.

Improved guidance material from the IISA should align with the current law and be practical in reflecting real industry examples of eligible and ineligible activities. In making such a recommendation it is acknowledged that the recently released draft guideline in relation to computer software development R&D activities represents a significant positive step toward guidance consistent with the terms of the legislation. Whilst we consider further refinement is required to overcome residual shortcomings in the computer software guidance, the document is indicative of a more positive attitude within AusIndustry to assisting industry claimants. We would like to see more industry specific guidance, ideally guidance prepared with industry and the ATO to help claimants understand the types of activities and expenditure that can and cannot qualify for the R&DTI. While we note that the ATO has strict protocols for publishing guidance products, the lack of meaningful ATO guidance material for the R&DTI programme has unwittingly created greater uncertainty and ambiguity within the programme. This starkly contrasts with the guidance the ATO provided in relation to the predecessor R&D Tax Concession for which IT2442, IT2451 and IT2552[8] provided a reasonably comprehensive and well-argued basis for information relating to eligibility, costing, and substantiation.

The extended period of time the ATO takes to publish guidance material has only exacerbated this uncertainty. Furthermore, the ATO references their online guidance 'amounts you can claim' which is updated every few years without any public announcement/consultation or release notes about their changes. As a result, claimants are subjected to a greater level of uncertainty than is necessary in regards to complex provisions of tax law. As noted in many of our responses above, guidance on appropriate apportionment principles using examples is critical as it is a constant area of disagreement between claimants and the ATO. We would like to see more industry specific guidance, ideally guidance prepared with industry and the ATO to help claimants understand the types of activities and expenditure that can and cannot qualify for the R&DTI akin to the Guide to the R&D Tax Concession produced under the former R&D Tax Concession program. Furthermore, this guidance material should be regularly updated based upon judicial decisions (following industry consultation).

[8] ATO. Taxation Ruling IT2442., Taxation Ruling IT2451., Taxation Ruling IT2552.

International models and experience

11. Our review includes an examination of the international R&D administration models. From your international experiences with similar programs abroad, is there any jurisdiction in particular that you consider to be appropriate for us to focus on for further analysis?

Through the BDO global network we have experience with many of the R&D incentives delivered through the tax system abroad. Whilst many jurisdictions have their own idiosyncrasies, with many operating under a single agency administration model, some of the better ideas we would advocate for that we believe would improve the efficiency and customer experience for claimants of the R&DTI in Australia include:

- Safe harbour of apportionment (Canada). Claimants in Canada have the option to use their own methodology to identify and apportion overhead expenses, or use a safe harbour apportionment based on the salaries of R&D employees. This would save claimants excessive time on trying to split expenses on a line by line basis to the activities
- A 'substantially all' rule (U.S.). If an employee spends 'substantially all' (i.e. greater than 80%) of their time on eligible activities, then the balance of their time is likely to be spent on administrative duties that directly support the R&D activities. Similar rules around accepting a reasonable estimate of time spent by staff on R&D activities exists in the U.K.
- Where there are four or more projects, you only include detailed descriptions of at least 3 projects (up to a maximum of 10), which between them cover 50% or more of your total qualifying R&D costs (U.K.). This would reduce the compliance burden for larger companies that have many projects
- Patent safe harbour(U.S): if a company has a patent it basically guarantees the activities qualify so there is less requirement
- Simplistic guidance using industry specific examples of the types of activities and expenditure that can qualify (UK, Canada, Ireland, NZ). Whilst each of these jurisdictions operate under a single agency model, there is significantly more guidance applicable to industry particularly with respect to qualifying expenditure for their respective program.

We also note that there are several commendable approaches to the administration and compliance of the New Zealand R&D Tax Incentive. Even though New Zealand has only recently introduced their R&D Tax Incentive scheme which incorporates many elements of the Australian R&DTI, the government department (IRD) that administers the program has taken a pro-active approach that they have publically disclosed aims to avoid many of the issues encountered with the Australian R&DTI. This includes the involvement of both technical revenue department staff and industry experienced staff from the previous Callahan grant program to be involved in both the administration and compliance aspects of the scheme. In addition, the IRD publishes specific industry guidance using realistic examples that addresses eligibility of activities and expenditure. Furthermore, it also engages directly with industry through an online public forum (loomio) where claimants can ask specific technical questions to other companies, advisors and the IRD outside of a formal compliance process. Whilst it is perhaps still too early to pass full comment on the success of such initiatives, it does reinforce the need for changes to how the R&DTI is administered here in Australia.

About BDO

BDO is one of the world's leading accountancy and advisory organisations. In Australia, BDO has more than 1,851 staff and 215 Partners in offices located in Queensland, New South Wales, the Northern Territory, South Australia, Tasmania, Victoria and Western Australia. Our global network extends across 167 countries and territories, with over 91,054 people working out of more than 1,658 offices.

In Australia BDO has 6 specialist R&D partners and more than 30 staff with backgrounds in accounting, law, science and engineering. Nationally, BDO assists over 400 entities with their R&DTI claims. BDO is a member of the National R&DTI Roundtable. In December 2018, 2 of BDO's partners, Nicola Purser and Graham Wakeman, were invited to appear before the Senate Economic Committee inquiry into proposed changes to the R&DTI.

Appendix A

Industry compliance example – Company A

By way of background, Company A is an Australian company founded in 1999. The company specialises in the development and support of ERP software solutions for complex inventory based businesses in a diverse range of industry sectors.

Company A has been accessing the R&D tax incentive since the program's inception and previously took advantage of the R&D tax concession. The incentive has been invaluable in assisting the company invest in the continued development of its bespoke solutions and to enable it to remain relative and competitive in its target markets.

The company is fully supportive of AusIndustry's role in ensuring compliance and retaining the integrity of the R&DTI program. However, the compliance process it experienced was drawn out over 22 months, and has been needlessly expensive, time-consuming and stressful for a small company that was found to be fully compliant with the program.

We have set out the extended timeline of the compliance process below.

In addition to the timeline, our concerns with the compliance process experienced by Company A, include:

- Neither Company A, nor BDO as its advisor, were alerted to a risk assessment undertaken on its 2016/17 registration (completed on 18 September 2018), nor the recommendation of an escalation to examination for the 2017/18 year. We believe Company A should have been notified of the status change, and the reasons for that change, to enable the R&D activities included in the application to be described in a manner clearly addressing the specific concerns
- Upon receiving the Notification of Examination pertaining to the 2017/18 registration, Company A offered, on more than one occasion to meet with the relevant AusIndustry personnel to discuss the registered R&D activities. In not being able to meet, Company A was not able to address issues directly and could only provide documentary evidence and descriptions that Company A believed answered AusIndustry's questions
- In examining Company A's response to the statement of issues, AusIndustry referred to a number of sources to support the finding that Company A's activities did not satisfy the definition of R&D. However, these sources were not technically relevant nor peer reviewed but rather opinion pieces (blogs) from individuals that would be considered to have less experience than Company A's development team
- The timeframe from which the notice of examination was provided to Company A (9 November 2018) through to the notification of the internal review outcome (4 September 2020) expanded over 22 months. The uncertainty associated with AusIndustry's decision impacted on Company A's business decision making processes. It also cost the company considerably in terms of time and resources to defend the claim. One contributing factor to this extended timeframe was the change in AusIndustry personnel undertaking the reviews. As a result of these changes, Company A was required to re-provide information to AusIndustry in a manner that the new personnel requested, exacerbating the resource commitment

- Whilst we understand that the Internal Review is undertaken as a de novo review, the company was left confused as to how the activities that were found to be all ineligible were then found to be eligible in entirety. Whilst additional evidence was provided during the internal review process, it was not clear from the report how the additional evidence assisted AusIndustry overturn its original decision or whether, for example, the ability to have a video conference enabled the assessor to contextualise the evidence thus presenting it in a new light; nor does the report provide any clear learnings to Company A to better present its activities going forward.

We understand that AusIndustry subsequently made changes to its compliance processes and its integrity framework and this should go a long way to ensuring companies in the future do not suffer the same anguish and consequences as Company A. However, we re-iterate our recommendations from this experience, for AusIndustry's consideration:

- Where AusIndustry has concerns over eligibility of activities these should be immediately raised and addressed with the company rather than waiting for lodgement of a subsequent registration
- A meeting or video conference should be held with the company at the outset of any compliance review process
- More than one assessor should be involved in each case to ensure continuity should an assessor move on
- The experience, qualifications and testimony of the company's internal experts should be well considered by AusIndustry
- Third party industry experts should be consulted and, where necessary, used as an intermediary to ensure the evidence presented is well understood
- A close out meeting should be held with the company to ensure that the company understands AusIndustry's decision outcome and the evidence that contributed to that outcome.

Timeline for Company A

Date	Event
26 September 2018	Company A lodged its 2018 Application
1 October 2018	Notification of registration received
9 November 2018	Notice of Examination of 2018 Application and Statement of Issues received
12 November 2018	Company A acknowledged receipt of the Notice of Examination and requested a meeting
13 November 2018	Company A was advised that AusIndustry would consider meeting after reviewing the evidence
6 December 2018	Company A requested an extension of time to provide a response
14 January 2019	Company A, via its advisor BDO, provided a response and supporting documentation, and reiterated the request for a meeting
Sometime between 14 January and 1 April 2019	BDO was notified that a new assessor had been appointed to the case. BDO verbally requested a meeting and was told that it would not be possible
1 April 2019	Finding received advising all activities lodged for the 2018 year were found to be ineligible
10 April 2019	Company A, via BDO, made an application for an internal review of the decision and again requested a meeting with the reviewer
28 May 2019	Company A was advised that an assessor from AusIndustry's Sydney office would be conducting the internal review and would be in contact the following week regarding a meeting
21 June 2019	Teleconference was held with two representatives from AusIndustry Sydney
2 July 2019	A sample of additional supporting evidence was provided to AusIndustry
3 July 2019	Clarification from AusIndustry regarding additional documentation sought with full response requested by 12 July 2019
11 July 2019	Additional response and documentation was provided to AusIndustry
16 July 2019	Receipt of information acknowledged by AusIndustry
29 November 2019	After numerous follow ups BDO was advised by AusIndustry that the case officer had been away and that he would provide an update the following week
29 January 2020	BDO received notification the case officer was no longer with AusIndustry and that the case had been reallocated
14 February 2020	Videoconference held with new case officers from AusIndustry

19 March 2020	Email received from AusIndustry seeking further clarification on the activities
17 April 2020	Further response to AusIndustry questions and further supporting documentation provided
20 May 2020	Courtesy update received from the case officer on the status of the internal review advising that the case was receiving high priority
7 July 2020	Further courtesy update received advising that the case was receiving high priority
25 August 2020	After follow up from BDO, email received from Manager Compliance – NSW & ACT, advising that an update would be provided that week
28 August 2020	BDO contacted AusIndustry General Manager to express concern about the length of time
4 September 2020	Internal review decision received advising all activities were found to be eligible

Appendix B

ATO compliance example – Company B

Company B was established in 2013 for the sole purpose to develop and commercialise an idea of Mr D. Mr D had a history of developing and commercialising electronic products for the likes of Sony, Raytheon and Siemens, among others through his company X Pty Ltd.

Given the strength of the idea, Company B attracted 3rd party investment and engaged Mr D's company, X Pty Ltd, an associated entity, to undertake engineering services on its behalf.

Company B claimed the R&DTI from establishment through to 2018 but ceased claiming due to the compliance actions of the ATO. In February 2020, the company received a grant from AustCyber to further develop and commercialise its technology, which had been recognised as critical to the cyber security of Australia's national infrastructure.

During the course of the development work Company B applied for, and were granted approximately 30 patents.

Similar to Company A, Company B understood the regulators role to conduct compliance activity and were forthcoming with information and documentation to support the claims made.

In regards to Company B's R&DTI claims, the ATO's key concern appeared to be that, by outsourcing the R&D activity to its associated entity, Company B was artificially increasing its ability to access R&D tax offsets. This was despite Company B having 3rd party shareholders. Other concerns of the ATO included the fact that X Pty Ltd did not maintain timesheets relating to the development work of its employees. This was despite the fact that it was solely engaged to conduct R&D activities on behalf of Company B and had maintained and provided copious other documents to support the employees' engagement in R&D activities.

On objection the claim was mostly denied on the basis that whilst the company had provided a substantial amount of information, that information was "too technical" for the ATO to be able to determine the appropriate expenditure the claimant was entitled to.

In the first conference in the AAT, the ATO challenged the eligibility of activities. Company B challenged the ATO's ability to make this assertion on the basis of the dual agency model, and the matter was referred to AusIndustry. It took 10 months for AusIndustry to provide a finding that all activities were eligible.

Whilst the matter was eventually settled in the AAT with the ATO allowing the full claim amounts, the drawn-out proceedings caused undue stress, time and expense for a small businesses that was ultimately acting in the best interest of Australia.

A timeline of the activity is provided below.

Timeline for Company B

Date	Event
19 July 2016	Company B Lodged its 2016 Income tax return
28 July 2016	Company B received its 2016 refund from its R&DTI claim
26 July 2017	Company B lodged in 2017 Income Tax return
4 August 2017	Company B received its refund from its 2017 R&DTI claim
11 October 2017	Company B received notice of review of its 2016 R&DTI claim
8 November 2017	Company B provided a response to the request for information by the due date including over 50MB of attachments
30 November 2017	ATO requested additional information
15 December 2017	Company B provided the additional requested information
24 January 2018	A meeting was held at Company B's premises to discuss the review with 3 ATO officers
23 February 2018	ATO advised the matter was going to audit for 2012-2016 years
16 March 2018	A 2nd meeting was held at Company B's premises with 5 ATO officers advised that 2013 – 2015 off the table but 2017 now under review
20 March 2018	ATO requested information for the 2017 year
30 April 2018	Company B provided a comprehensive response to the ATO request
18 May 2018	Further request for information received from ATO
13 June 2018	Company B provided a response to further request for information
20 June 2018	Position paper received in respect of 2016 and 2017 years denying all but subcontract expenditure
17 August 2018	Company B lodged response to the Position Paper
30 October 2018	Company B received Reasons for Decision for the 2017 year
27 February 2019	Company B lodged objection against amended notice of assessment
2 August 2019	ATO requested further information regarding the objection
5 September 2019	Company B provided response to request for further information
6 September 2019	ATO provided a second request for further information regarding the objection
24 October 2019	Company B provides second response to request for further information
9 March 2020	Company B received Reasons for decision against objection and the objection was denied

13 March 2020	Company B submitted application to AAT
16 April 2020	First conference held with AAT
22 May 2020	Matter referred to AusIndustry
10 August 2020	First meeting held with AusIndustry
September 2020	Mr D passes away
4 December 2020	Second meeting held with AusIndustry
13 March 2021	AusIndustry issued finding confirming all activities eligible
29 April 2021	Second conference held with AAT
23 June 2021	Third conference held with AAT Meeting at BDO premises with Company B and ATO. ATO agreed to settle matter for full amount