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Dear Sir

Submission on the Board of Taxation (BoT) review of the dual administration of the R&D Tax Incentive (R&DTI) program

PwC welcomes the opportunity to make a submission to the BoT review of the dual administration of the R&DTI program. We support the Government's initiative to request the BoT to evaluate the R&DTI dual agency administration model, with a view to identifying opportunities to reduce duplication between the two administrators (being the Australian Taxation Office (ATO) and Industry Innovation and Science Australia (IISA or AusIndustry)), simplify administrative processes, or otherwise reduce the compliance costs for applicants.

Our submission and recommendations are further outlined below. We recommend considering multiple of these recommendations be adopted in conjunction to reduce compliance costs for taxpayers, improve certainty and transparency and better meet the objectives of the R&DTI whilst maintaining integrity in the program. In summary:

1. The current R&DTI administration model creates unnecessary duplication for claimants (as reviews and audit activity is often conducted by the two regulators at different times and without consultation with each other), increasing their compliance costs for applications, lacks certainty and transparency and legal avenues for review of regulator decisions denying claims are effectively not accessible to many claimants as they are cost prohibitive.

2. Given the objective of the program is to encourage R&D activity in Australia, to achieve this objective there needs to be a more collaborative approach to administration of the program by the regulators.[1] Consideration should also be given to changing the burden of proof to the regulators (rather than claimant) to better achieve the program's objectives.

3. Moving to one administration model would prima facie create efficiencies, reduce administration costs and create more certainty but only if the regulator's approach to

[1] For example, see the Canadian approach to R&D reviews at: https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4088/guide-form-t661-scientific-research-experimental-development-expenditures-claim-guide-form-t661.html

reviews was to significantly change from current practices. This could include greater use of technical experts to review the activities, collaboration between the technical reviewer and the expenditure reviewer, reducing the length of time between lodgment of claims and reviews, clearer guidance on evidentiary requirements that is tailored to the size of the business and not one size fits all. If a single regulator model is adopted, it should be undertaken in conjunction with other recommendations as set out herein.

4. Reduce the period of review to reduce inconsistency and uncertainty. To create greater certainty and confidence for claimants in the registration process, the period of review of R&D applications by AusIndustry should be shortened, for example six months for refundable offset taxpayers and 12 months for non-refundable offset taxpayers.[2] In conjunction, there should be a mandate for ATO officers undertaking a review of the expenditure to consult and seek advice from AusIndustry as to the basis of the decision to accept the R&D registration and the onus should shift to the ATO to prove that the expenditure does not relate to the registered R&D activities. In addition, there should be more transparency and collaboration during the review process, and information shared between the two regulators or between officers considering technical and expenditure aspects, should be shared with the claimant.

5. Consideration should be given to setting up a specific cost-effective Tribunal (e.g., like the Small claims Tribunal or the Land and Environment Court) with appropriate technical expertise to deal with disputes between the regulators and claimants in a more cost effective and efficient way. This should reduce the cost of litigation and increase access to review options to small businesses.

Details - Basis of our submission and recommendations

The legislative stated policy objective of the R&DTI program is to encourage industry to conduct R&D activities that otherwise may not be conducted, particularly where the new knowledge gained is likely to benefit the wider Australian economy.

Over the past five years the approach taken to review of R&DTI claims by AusIndustry and the ATO has resulted in many claims being rejected in full or in part, and companies having to repay tax (and in some cases with penalties and interest). This has led to financial ruin for some companies. Importantly, it has also discouraged industry to continue to undertake R&D or has led to R&D activities being moved to overseas jurisdictions.

The current dual agency administration model and the review practices adopted by the two administrators, AusIndustry and the ATO, have often failed to meet the program's objectives for several reasons, some of which are highlighted below under the broad categories of certainty, transparency and compliance costs.

[2] For example, the period of review of registrations in Canada is 180 days for refundable claimants. See - https://www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program/program-service-standards.html

It is noted that the dual agency administration model is not used extensively in overseas jurisdictions. For example, the USA, UK, Singapore and Canada all use a single administration body. While New Zealand has recently introduced an R&D scheme modelled on the Australian program, due to its infancy we consider it is too early to comment on how effective the dual administrators have been.

1. Certainty

- The current R&DTI registration process by its very nature gives claimants the initial impression that once activities are registered by AusIndustry they have been assessed as eligible under the R&DTI program. However, AusIndustry has up to four years from the end of the financial year in question to review the eligibility of those activities, meaning a company could be asked for very detailed information about those activities up to five years after they occurred and even longer depending on how long the review continues. This creates uncertainty and lack of confidence in the registration system, particularly for businesses where there has been staff turnover or smaller businesses that do not have adequate resources and sophistication to understand the process. It should also be noted that currently the period of review for small business entities is two years for review of income tax assessments but four years for R&D applications, creating confusion and uncertainty in relation to their compliance obligations.

- Claimants are less certain than ever about both the eligibility of activities and the expenditure that can be claimed in relation to those activities. This is despite the fact the Full Federal Court (FFC) in recent years has clearly ruled on how the law should be interpreted from an eligible activity perspective (e.g., Moreton Resources case[3]) and the approach that should be taken in assessing evidence as outlined by the Administrative Appeals Tribunal (AAT) in the PKWK AAT decision[4]. Part of the reason for claimants' lack of certainty and confidence in the consistency of the regulator's interpretations during reviews stems from the apparent hesitancy of AusIndustry to clearly acknowledge the findings of the FFC and the AAT and to quickly adopt the views in public guidance and reviews in progress. A second aspect is that it has been observed that the ATO often makes decisions about the eligibility of activities when clearly this is not their mandate. The basis and reasoning for the ATO doing this is tenuous but allows for questioning and denial of expenditure claims often with a degree of ambiguity.

- There are two distinct claimant communities - namely refundable and non-refundable - and the regulators apply a one size fits all approach to administering the system. While we understand why this occurs, the process ignores considerations such as the sophistication of the taxpayer, the cost of compliance relative to the benefit, as well as the relative compliance cost to other tax deductions.[5]

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[3] See **Moreton Resources** Ltd v Innovation and Science Australia - [2019] FCAFC 120, 25 July 2019
[4] *PKWK* v *Innovation and Science Australia* 2021 ATC ¶10-570; [2021] AATA 706, 24 March 2021
[5] The Australian Small Business and Family Ombudsman undertook a review of the R&DTI in 2019. For more detail regarding the impact of the administration of the R&DTI on small business and recommendations regarding changes that should be made see: https://www.asbfeo.gov.au/news/news-articles/ombudsman-recommends-sweeping-changes-rd-tax-incentive-administration

- The dual administration system further impacts certainty, for example, AusIndustry may approve the claim, but the ATO may deny it in full. The regulators often undertake their reviews at separate times and without any collaboration with each other or the taxpayer. The process is often very adversarial with a 'guilty until proven innocent' approach and a very strict documentary burden of proof (e.g., requests for information to prove that salary and wages claimed relate to specific minute R&D tasks on a daily or even hourly basis rather than taking a balance of probabilities approach that those activities were conducted by the person based on the entirety of the evidence) adding to the lack of taxpayer confidence in the system.

- Given the R&DTI is self-assessed, the best outcomes are achieved when certainty can be expected by claimants (i.e., no surprises). This requires clear and relevant guidance materials. We note that the ATO has not issued a final public ruling on R&D since the new law was implemented but has issued five Taxpayer Alerts. AusIndustry does not issue rulings or an equivalent of an ATO Interpretative Decision (ATOID), which would be beneficial for education, transparency and ultimately certainty.

- The guidance materials that have been issued by AusIndustry and the ATO (various guides and taxpayer alerts) lack specificity in some respects, were issued years after the program commenced, yet are often applied to reviews retrospectively and as representing the correct interpretation of the law even for periods where the guidance materials were not in existence.

2. Transparency

- Linked to the certainty issue, claimants are entitled to understand the administrative processes applied to their R&D claims and this requires transparency. As mentioned above there has been inadequate guidance materials from the regulators to outline their specific requirements, particularly in relation to evidence expectations. In addition, there is inconsistency between the approach of different officers within each of the regulators. This has led to many claimants forming the view that the AusIndustry process is at best described as 'opaque' and that the ATO is reluctant to adhere to clearly defined protocols until reviews/audits get to the objection/appeal process (at which point they assess litigation risk). The ATO approach at present is heavy handed and again ignores the sophistication of the taxpayer, the cost of compliance relative to the benefit, as well as the relative compliance cost to other tax deductions.

- Better compliance outcomes would be achieved through greater transparency and understanding by taxpayers of the regulator's perspective. For instance, what resources does AusIndustry rely upon to arrive at their decisions (e.g., website searches, internal databases, independent experts etc.)? Although Ausindustry visits to client sites were common during the early stages of the program, during more recent years, Ausindustry reverted to a less collaborative approach and at one stage refused to undertake site visits that could better inform decisions of eligibility.

- We note that both regulators are reluctant and do not share with stakeholders the level of review activity, matters progressing to litigation etc. This has the effect of undermining trust in the system.

3. Compliance Burden

- For many reasons, including those mentioned above, the cost of compliance is a concern for many taxpayers. Even for larger companies where the ability to fund compliance costs during a review is not in itself an issue, the size of the R&D benefit versus the cost of compliance is often not commensurate creating a commercial deterrent to challenging the regulators' position. For this reason, many taxpayers and in particular small businesses have no real rights of review. This is not an ideal position for a tax system that is based on principles of fairness and equity for all taxpayers, regardless of size.

- The dual administrator system also greatly adds to compliance costs. Managing the review requests of two regulators is an extraordinarily expensive and onerous task, particularly as the reviews are seldom conducted at the same time, can take years to resolve and often commence many years after the R&D activities were undertaken. This is especially the case because the onus of proof is on the claimant. So even if the law was clear (which it is not) then the taxpayer's claim may still be rejected, even if there was legitimate R&D activity but it cannot be proven, or the taxpayer spent the money but cannot prove it to the onerous degree expected by the regulators.

- Compliance costs for claimants are also increased because officers reviewing claims are not technical experts (e.g., AusIndustry officers do not always have technical knowledge of the subject matter and ATO officers assessing R&D expenditure may not work together with technical experts), and accordingly struggle to understand and interpret the R&D concepts and explanations provided by the taxpayers. This is also an issue for lawyers where reviews proceed to litigation.

We would welcome the opportunity to attend further consultation forums as appropriate. Should you have any questions or would like to discuss the above in further detail, please contact me on 0417208230.

Kind regards

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