


TA 2017/3 - Claiming the Research and Development Tax Incentive for ordinary business activities

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This Alert has been jointly developed by the Australian Taxation Office (ATO) and Department of Industry, Innovation and Science.

The Research and Development (R&D) Tax Incentive is jointly administered by Innovation and Science Australia (supported by AusIndustry within the Department of Industry, Innovation and Science) and the ATO.



Australian Government

Australian Taxation Office

Department of Industry,
Innovation and Science

Taxpayer Alert

TA 2017/3

Claiming the Research and Development Tax Incentive for ordinary business activities

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Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more about Alerts. See [Alerts](#) issued to date.

Description

The ATO and AusIndustry are reviewing arrangements of companies that are claiming the R&D Tax Incentive where some (or all) of the expenditure that is incurred relates to their ordinary business activities and not to eligible R&D activities.

These types of arrangements exhibit some or all of the following features:

- A company registers one or more activities for the R&D Tax Incentive.
- Some or all of the activities registered are broadly described and non-specific. For example, projects may be registered instead of the specific activities undertaken.
- Some or all of the activities registered are ordinary business activities that are not eligible for the R&D Tax Incentive.
- Some or all of the activities were undertaken in the course of their ordinary business activities and recharacterised as R&D activities at a later time.
- The company claims the R&D Tax Incentive for expenditure that is not on eligible R&D activities.

Background

The Australian Government supports companies that undertake eligible R&D activities through the R&D Tax Incentive.

Eligibility for the R&D Tax Incentive is based on specific R&D activities rather than on entire commercial projects.

In order to be eligible, there must be an experiment or experiments being carried out for the purpose of generating new knowledge. The outcome of the experiments cannot be able to be known or determined in advance by a competent professional in the field. The experiments being carried out must be based on principles of established science and must seek to prove whether specific technical hypotheses are right or wrong to resolve specific technical issues or risks.

Supporting activities may also be eligible if they are directly related to eligible experimental activities. It is not sufficient that these activities are related to the project more generally. Additionally, in some circumstances supporting activities must also be conducted for the dominant purpose of supporting the experimental activities.

Ordinary business activities are not generally carried out for the purpose of generating new knowledge. Such activities may include solving business problems using established products and existing knowledge, expertise or methodologies. Further, activities that produce or are directly related to producing goods or services are not usually undertaken for the dominant purpose of supporting experimental activities.

Under the R&D Tax Incentive, companies self-assess the eligibility of their activities and register through AusIndustry. Companies then claim a tax offset (the R&D Tax Incentive) for their 'notional deductions' relating to eligible expenditure through the annual company tax return. The registration of activities does not, by itself, render the activities described in a registration as eligible R&D activities for the purposes of the R&D Tax Incentive. The ATO and AusIndustry may review the eligibility of activities or expenditure after registration.

The R&D Tax Incentive claimed in a company's tax return must relate only to expenditure on eligible R&D activities.

What are our concerns?

The operators of some affected companies may believe (or have been advised) that their activities constitute eligible R&D activities. However, we are concerned that:

- Activities may not fit within the stringent requirements of the laws that govern the R&D Tax Incentive.
- Expenditure claimed may not relate to eligible R&D activities.
- Taxpayers may not be applying adequate levels of governance and review to the registered activities and the claims made for the R&D Tax Incentive.

Activities

We have observed a number of cases where the company's ineligible ordinary business activities have not been distinguished from any eligible R&D activities. For example:

- No R&D activities are being conducted at all; only ineligible ordinary business activities are being conducted.
- The scope of claimed activities includes a mixture of eligible R&D activities and ineligible ordinary business activities.

- R&D activities which were being carried on have transitioned into ordinary business activities but claims for the R&D Tax Incentive are still being made.

Activities may not be eligible for the R&D Tax Incentive because:

- Their purpose is not sufficiently concerned with the generation of new knowledge. For example:
 - The activities have no significant knowledge-generating purpose; or the generation of knowledge is merely incidental to an ordinary business activity.
 - Activities which were formerly carried on to generate new knowledge have achieved that purpose and are now ordinary business activities.
- The activities do not involve an application of the scientific method; that is, proving or disproving a hypothesis through experiments.
- The activities are not directly related to experimental activities or do not have a dominant purpose of supporting such activities.
- Project management, environmental, commercial or economic risks are mistaken for technical risks.

Expenditure

We have also observed that often some of the expenses included in the calculation of the R&D Tax Incentive claim are not for amounts that relate to eligible R&D activities, for example, ordinary production costs of products sold to the market in the ordinary course of business.¹

In some cases expenditure is being claimed under the R&D Tax Incentive even though no R&D activities are being conducted.

In other cases, expenditure is being apportioned between R&D activities and ineligible business activities in an unreasonable manner. For example:

- Expenditure is included as part of overall overhead expenses which does not relate to R&D activities for example, advertising and sales expenses.
- Overhead expenses are apportioned using a method that allocates an unreasonably large amount to R&D.

Corporate Governance

Companies are expected to distinguish eligible R&D activities from ineligible ordinary business activities at the time of registration and throughout the conduct of the activities. Proper, detailed and contemporaneous records must be kept to support the registration application and the claim for the R&D Tax Incentive.

We are also concerned that some companies are not applying adequate levels of governance and review to the R&D activities that have been registered and to the claims that are subsequently made for the R&D Tax Incentive on their behalf. For example, we have observed:

- Suitably qualified company officers or employees who understand the relevant activities failing to undertake reviews and approvals of the company's R&D registration applications.

¹ Note specific legislation applies to feedstock; see section 355-465 of the *Income Tax Assessment Act 1997* or refer to the ATO Factsheet on Feedstock.

- Company management deferring responsibility for distinguishing ordinary business activities from R&D activities to external advisors, without checking whether the external advisors' understanding of the eligible activities aligns with that of the company's officers or employees.
- Accounting systems or records being kept which do not contemporaneously or adequately segregate R&D expenses from other expenses.

We have observed that these practices can result in activities being registered as R&D activities and expenditures being claimed under the R&D Tax Incentive that should not be.

What are we doing?

The ATO and AusIndustry are working together to alert taxpayers and their advisors to practices that may result in increased risk of registering ineligible activities and incorrectly claiming the R&D Tax Incentive.

We will be contacting companies directly to advise them of our concerns with their registered activities and/or their R&D Tax Incentive claims if:

- Advisors who may apply high risk practices are involved in the preparation of the registration application and/or claim.
- The registration of R&D activities continues with the use of broad descriptions that fail to distinguish them from ordinary operational business activities.
- The level of expenditure claimed for the R&D Tax Incentive is high for the industry or stage of business.

Innovation and Science Australia will continue to issue Findings to companies confirming whether activities qualify for the R&D Tax Incentive.

We have developed further guidance products to assist companies, and their accountants and advisors, to correctly identify and document eligible R&D activities. This product is available on www.business.gov.au

What should you do?

You should consider whether our concerns apply to you. The onus is on you to ensure that your registration and claim for the R&D Tax Incentive are correct. We would encourage you to:

- Review your registration to ensure you are registering only eligible R&D activities.
- Ensure your claim for the R&D Tax Incentive is correct and that you are not claiming expenditure related to ineligible ordinary business activities.
- Have the records to demonstrate the R&D activities being undertaken and support the associated R&D Tax Incentive claim.

If you consider that our concerns apply, you may want to:

- Phone us at the contact details provided below.
- Seek independent professional advice.
- Ask the ATO for our view through a private ruling or apply for a Finding from Innovation and Science Australia.
- Apply to AusIndustry to amend or withdraw your registration or make a voluntary disclosure to the ATO or amend your tax return.

Penalties may apply if you have incorrectly claimed the R&D Tax Incentive but will be significantly reduced if you make a voluntary disclosure. Generally, the reduction is greater if you make the disclosure before we notify you of an examination of your tax affairs.

Sanctions under criminal law may apply to fraudulent claims.

Registered tax agents, including R&D Consultants, advising companies to incorrectly claim ordinary business activities may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*. Promoter penalty laws may also apply under Division 290 of Schedule 1 to the *Taxation Administration Act 1953* for promoters of schemes to access the R&D Tax Incentive for ineligible activities.

For more information about eligible R&D activities, what can be claimed under the R&D Tax Incentive and recordkeeping, refer to [Research and development tax incentive](#).

Do you have information?

To provide information about this or another arrangement, or a promoter of this or another arrangement:

- phone us on **1800 177 006** (after the initial messages, wait for the 'Taxpayer Alert' option then press 1), or
- complete the [ATO Tip-Off Form](#)

References

Legislative References:

Income Tax Assessment Act 1997

- 355-465

Tax Agent Services Act 2009

Taxation Administration Act 1953

- Div 290 Sch 1

Related Taxpayer Alerts:

- TA 2017/2

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