



TA 2017/4 - Claiming the Research and Development Tax Incentive for agricultural 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.

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Taxpayer Alert

TA 2017/4

Claiming the Research and Development Tax Incentive for agricultural 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 the arrangements of entities that are claiming the R&D Tax Incentive in respect of agricultural activities where some (or all) of the expenditure incurred is on activities which are not eligible R&D activities.

In Taxpayer Alert TA 2015/3 we highlighted our concern with entities involved in broadacre grain farming. We are now concerned that other entities engaged in agricultural activities, such as those operating orchards, vineyards, olive groves, forestry operations and fibre growing businesses, may be inappropriately claiming the R&D Tax Incentive under similar circumstances.

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

- An agricultural business is being carried on, often by an entity that is not eligible for the R&D Incentive, for example a family trust.
- The operators of the agricultural business are approached by a promoter/R&D consultant advising that the farming activities that are being carried on are eligible for the R&D Tax Incentive.

- Where necessary, a new special purpose R&D company may be incorporated in order that the activities are conducted by an entity that is able to claim the R&D tax offset.
- A company registers one or more activities for the R&D Tax Incentive.
- The registered activities involve the application of farm products or practices across all or a significant part of a farm or farms.
- Some or all of the registered activities have the character of ordinary farming activities whose main purpose is the production of crops.
- 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 companies have registered agricultural activities with AusIndustry which are, or appear to be, ineligible for the R&D Tax Incentive. The reasons these types of activities have been found to be ineligible include:

- The activities form part (or all) of the entity's ordinary business activities¹, such as the production of agricultural goods, and are not for the purpose of generating new knowledge or for the dominant purpose of supporting core R&D activities.
- The activities involve the application of established products and existing methodologies and a competent professional in the field could have known or worked out the outcomes without conducting an experiment. For example, applying different irrigation or pruning methods, commissioning new equipment or applying soil improvers in different concentrations.
- The activities are not experimental and are not undertaken to prove a hypothesis right or wrong. This is evidenced by the scale of the activities which is disproportionate with the scale of any data collection, observation and evaluation.
- The activities are replicated across several farms to test the suitability on different soil types and the activities involve products and techniques that are known to work and are not for the purpose of developing new knowledge.
- The activities are not directly related to eligible experimental activities and do not have a dominant purpose of supporting such activities.

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.²

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.
- Overhead expenses are apportioned using a method that allocates an unreasonably large amount to R&D.

¹ See Taxpayer Alert TA 2017/3 for more information.

² 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.

Other issues

We are also concerned that the structures being used may lead to other issues that will make the activities or expenditure ineligible for the R&D Tax Incentive including:

- Whether the activities are being conducted by the company on its own behalf or for the entity carrying on the agricultural business.
- Whether arrangements between related entities are conducted on an arm's length basis.
- Whether amounts billed to the R&D company by related entities are paid.
- Whether the documentation between related entities adequately demonstrates who is undertaking the activities, who has paid for the activities and who benefits from the results of the activities.

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.
- 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 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 a Specific Issue Guidance product to assist companies engaged in the farming industry, and their accountants and advisors, to correctly identify and document eligible R&D activities in that industry. 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 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 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 060 062 or
- complete the [ATO Tip-Off Form](#)

Amendment history

Date	Comment
19 January 2024	Updated ATO tip-off hotline number

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 2015/3
- TA 2017/3
- TA 2017/5

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