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Board Of Taxation Secretariat
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Dear Sir/Madam

Board of Taxation Review of the Research and Development Tax Incentive Dual Administration Model

Overview

Michael Johnson Associates (MJA) welcomes the opportunity to make this submission to the Board of Taxation (BoT) which is conducting an evaluation of the dual agency administration model of the R&D Tax Incentive (RDTI).

In preparing this submission, MJA is focusing on some of the aspects highlighted in the BoT's Consultation Questions, rather than seeking to address all the issues raised. As such, we will consider the current state of play, with some suggestions as to how to improve some of the shortcomings as we perceive them, rather than reflecting on issues and areas for improvement that have already been largely addressed in recent years.
We also have limited ability to contribute to some matters being canvassed such as international models and experience.

We are delighted to have been included in the BoT Working Group and we hope to provide insight on some other areas of the review and would seek to bring specific taxpayer experiences to the Review in that context.

In preparing this submission, we have assumed that there are no plans to move to a different delivery model (e.g. single agency) as this is not explicitly referred to in the Terms of Reference. If it emerges that this option is subsequently on the table, MJA will respond at that time as we are firmly of the belief that the correct focus is on improving the current dual agency administration, rather than switching to an alternative model.

We submit that the Review is ideally timed, given where the RDTI is in its lifecycle. The current R&D climate in Australia clearly exhibits a divergence of apparent viewpoints, and there is a very specific need to understand the distinctions in the roles and responsibilities of AusIndusty and the Australian Taxation Office (ATO) in the wake of a recent legal decision (*Commissioner of Taxation v Auctus Resources Pty Ltd [2021] FCAFC 39)*. This case threatens the commonly held understanding that there is a clear split in the responsibilities of program delivery between AusIndustry and the ATO. We recommend that legislation be introduced to ensure that the different roles and responsibilities are "distinct and clearly understood", to use the words of the BoT's Consultation Questions (Question 1).

We also provide recommendations that seek to assist the means by which the regulators can deliver the best possible program outcomes whilst affording a clear commitment to program integrity. We do so in the belief that all genuine stakeholders have a coincidence of interest in the RDTI, centering around Australian taxpayers receiving their maximum allowable benefits under the R&D tax legislation. In achieving this, we will highlight areas where true collaboration between stakeholders can avoid a number of the pitfalls that keep occurring in the rollout of measures such as rulings, guidance and claim procedures (eg. the new registration portal). We also shine a light on the disparities that exist in the timeliness of the outputs from the regulators and their expectations regarding stakeholder input.

To do so means that oft-expressed values around transparency, cooperation and trust need to be become realities, rather than given mere lip service.

We acknowledge that improvements must also be realised in the behaviour of claimants and advisers, and we would readily contribute to any future review of these vital ingredients for program success.

With the RDTI moving into a new era with legislation that commenced on 1 July 2021, this review represents a golden opportunity to launch a better RDTI for all concerned.

About MJA

MJA is a national professional services firm that specialises in assisting Australian companies in accessing Federal Government support programs for innovation with a particular focus on the Incentive. Our specialist team of engineers, scientists, miners, IT professionals, accountants, tax experts and lawyers have extensive hands-on experience in the preparation of Incentive claims Australia-wide and our team understands exactly how client technology links to the R&D tax rules.

MJA currently services over 200 organisations operating in all Australian states and territories. These organisations range in size from small start-ups to ASX Top 100 listed companies. Since the R&D tax rules commenced in 1985, we have prepared claims in all sectors ranging from manufacturing, information technology, telecommunications, biotechnology, mining and fast-moving consumer goods.

MJA is recognised as a thought leader in the field and we have genuine relationships with the relevant government bodies including the Department of Industry, Innovation and Science, AusIndustry, Treasury and the Australian Taxation Office (ATO). MJA was instrumental in the consultation process in setting up the R&D Tax Concession program back in 1985 and we have continued this tradition through our participation in the 2008 National Innovation Review and the 2009-2011 R&D Tax Incentive

In 2011, MJA became a founding member of the Federal Government's R&D Tax Incentive National Reference Group (NRG). The NRG provided key stakeholders and administrators with a forum for the identification, prioritisation and discussion of views on significant technical and administrative issues relating to the Incentive. In 2019, the NRG was replaced with the RDTI Roundtable and MJA Chair, Kris Gale, was invited to be a founding member. Kris has advised Australian companies regarding R&D tax legislation since 1987 and, as such, he is believed to be the longest-serving consultant in this area. Kris was replaced on the Roundtable by Sarah Lander, MJA Managing Partner, in 2021.

Our academic credibility is reflected by the fact that MJA is responsible for writing the CCH Master Tax Guide on the R&D Tax Incentive. Beyond the Incentive, MJA has consulted extensively in a range of other Federal Government innovation and venture capital programs as well as working with a diverse range of organisations on the best ways to capitalise on the advantages offered by innovation.

Why the Review is Ideally Timed: The Program Lifecycle

MJA has assisted hundreds of Australian taxpayers access the RDTI and its predecessor program, the R&D Tax Concession (the Concession), since 1985. Kris Gale, the author of this submission, has worked with MJA since early 1987 and has direct experience spanning more than 34 years.

This longevity enables a perspective not available to other program stakeholders. We have noticed a recurring lifecycle in the attitude reflected in the delivery and administration of the programs by the regulators over the history of the R&D tax programs:

Phase 1 – Promotion	The benefits of the program are widely promoted and participation is encouraged.
Phase 2 – Crackdown	Focus shifts to expressed concerns about claimant and adviser behaviour. Claims are heavily scrutinised and often rejected. Participation rates drop.
Phase 3 – Balance	Court decisions set out the parameters of the program and all parties are settled in their behaviour. Participation rates begin to climb again.
Phase 4 – Value Decision	The Government resets the dials in terms of the value of the tax benefits offered.

The Concession went through two cycles between its conception and when it was replaced by the RDTI:

- 1985 – 1996
  Milestones included the retention of the 150% concessional rate throughout the period, the rejection of the 'dominant purpose' test applying to directly related R&D activities in the early Nineties and, ultimately, the cut in the rate to 125% in the 1996 Federal budget

- 1996 – 2011
  This period saw the retention of the 125% rate, along with the introduction of Premium and Rebate features, in 2000, and the protracted review process that commenced in 2008 by the National Innovation Review and resulted in the more valuable RDTI

The RDTI has come to the end of its first cycle, emerging from the dual challenges of the 2015-2019 'crackdown' and the proposed cuts to program value, with new legislation that commenced on 1 July 2021 offering an incentive with unchanged definitions of R&D activities and R&D expenditures and some value enhancements. It is our belief that understanding the repeated behaviours observed over this history can be used to bring valued stakeholders together more cohesively so that the output of the dual agency delivery model is one that seeks to constantly promote program participation and benefits whilst ensuring program integrity is not compromised.

With the new provisions just starting to take effect, the BoT Review can be a catalyst to ensure that the course settings of the regulators, along with the expectations of taxpayers and their advisers, are promotional, appropriate and sustainable.

Why The Review Is Ideally Timed: Climate of the Review

Earlier this month, the Australian Government published an article on its business.gov.au website celebrating 10 years of the RDTI, noting that more than 30,000 companies have accessed the program since it began in July 2011 including 2,000 to 3,000 new businesses per year:

Celebrating a decade of the Research and Development Tax Incentive | business.gov.au
The 2011 legislation was applauded for making the government support framework far more attractive that the predecessor Concession which was being accessed by 8,000 companies at the time of the RDTI's introduction.

This "celebration" coincided with the recent publication of Australian R&D expenditure figures that spoke to a decline in real terms of Australia's R&D performance over the period of the RDTI's operation to date. In FY 2012, Australia spent $18.3 billion on R&D which was 2.11 % of GDP. Eight years later, in FY 2020, the spend was down to $18.17 billion, representing only 1.79% of GDP. It goes without saying that other economies are observed to be moving in the opposite direction.

In short, R&D performance has declined in the 10 years following the introduction of a more valuable and attractive government support measure. A brief discussion of program participation is merited in this context.

At the recent 1 September 2021 RDTI Roundtable, the number of R&D registrants for 2019/20 was given as 11,485 which is down from the program's peak of approximately 15,000 some 4 or 5 years earlier. Let's be generous and say that there are 12,000 current participants which is about 4,000 more than when the RDTI began in 2011.

Let's say all 8,000 companies carried over from the concession and claimed the RDTI in its first year. And let's take the low side of the claim in the above article and impute that 2,000 new businesses joined the program each year ie. 20,000 in the first ten years. So 8,000+ 20,000 = 28,000 companies have used the RDTI which accords with the claim by the Government that 30,000 companies that have used the program. But it does beg the serious question as to why 18,000 companies have left in the same time period.

The dual agency administration model needs to be examined in that context. Curiously, at the same Roundtable, the Government claimed that only approximately 400 companies had departed the program in FY20 and theorised that the causes might include COVID-19 and the national bushfires.

This feels like a clear understatement based on the logic of their own figures but, nonetheless, there appears to be no doubt that there are a number of other factors at play regarding the net loss of claimants. We submit that the reputation of the RDTI has suffered mightily since 2015 through a variety of factors including, critically, the performance of the two regulators and these factors have played a central role in the documented decline.

A major issue has been the impact of the reductions in program value, real and anticipated, over the life of the RDTI to date.

In 2015, the first paring back of the value of the program was the introduction of an annualised company group claim limit of $100 million. This was followed by the offset rate cuts of 1.5% following the 2016 Federal Election and the draft legislation that emerged from the well-known Triple F Review that was on the books for the best part of 3 years. This legislation dramatically cut the value of the program and represented an existential threat that was only ended by the replacement of the legislation that commenced on 1 July 2021 that was announced in the October 2020 Budget off the back of the pandemic.

These real and potential cuts in value eroded confidence in the program and go some way to explain the net fall in program participation since 2015.

Compounding the problem was an expressed lack of confidence in the Government's flagship innovation program by key figures such as the former Treasurer, Scott Morrison, and the Commissioner of Taxation, Chris Jordan.

Speaking in support of the legislation to reduce the value of support, Treasurer Morrison said at a conference in April 2018 that the program as being "taken for a ride' by some: https://www.afr.com/politics/scott-morrison-to-reveal-overhaul-of-3b-rd-tax-incentive-in-may-budget-20180405-h0ycqa

In the wake of the release of the highly persuasive Australian Small Business And Family Enterprise Ombudsman (ASBFEO) Report, "Review Of The R&D Tax Incentive (RDTI), https://www.asbfeo.gov.au/reviews/rd-tax-incentive, Commissioner Jordan remarked at the Council of Small Business Organisations of Australia National Small Business Summit in August 2019 that the RDTI was problematic "structurally" and he went on to say "I would gladly abdicate the role of R&D compliance".

These statements by the then Treasurer and the Commissioner were terribly detrimental to the confidence of program stakeholders and this surely has played in the departure of many registrants.

Finally, the observed performance of both AusIndustry and the ATO over this period must be taken into consideration. The 2015-2019 period, now commonly referred to as the 'crackdown', saw mainstream press coverage of the difficulties companies were encountering and the stories caused considerable alarm in the innovation community. The positions on matters of eligibility and evidence taken in audits by both regulators have often not held up under scrutiny as reflected in key legal decisions and independent reports such as delivered by the ASBFEO.

MJA submits that factors such as those described above have been more fundamental than others such as COVID-19 and bushfires in undermining the confidence in and performance of the RDTI including the design, delivery and performance of the dual agency administration model. This has translated to the overall decline in program participation in the past 5 years and the documented stagnation in Australia's R&D performance.
As we are less than 3 months into the new benefits regime, it is an ideal time to work in a collegiate manner to seek to deliver genuine program improvements that meet the agreed goals including, most importantly, program integrity.

Why The Review Is Ideally Timed: The *Auctus Resources* Case

The recent consultation sessions conducted as part of this BoT review has drawn attention to some concerning *obiter dicta* that appeared in a 2021 Federal Court decision. The case of concern is:

Commissioner of Taxation v Auctus Resources Pty Ltd [2021] FCAFC 39
https://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/full/2021/2021fcafc0039

The key paragraph in the judgement is:
"32 Registration by an R&D entity of particular activities as being "core R&D activities" or "supporting R&D activities" under s 27A of the IRD Act, whilst a necessary requirement to be eligible for the tax offset refund, is not conclusive of such activities having the character of being "R&D activities". Either the Commissioner or the Board might conclude that they are not. The Board might do so by making findings under ss 27B or 27J. If the Board has not made findings (which is often the case), the Commissioner might form his own views about whether a taxpayer's activities are R&D activities.

As the legislation currently stands (tax offset refunds being part of the process of assessment), if the Commissioner took the view that particular activities were not R&D activities and there was no binding finding about that, then the Commissioner would have to act on his view in performing his assessment obligation under s 166 of the ITAA 1936. In fulfilling his duty, the Commissioner is bound by a finding made by the Board if one happens to exist (s 355-705), but is otherwise responsible for administering the tax laws according to their terms. The Commissioner is not bound by the taxpayer's self-assessed view that their activities are "R&D activities". If it were otherwise, the taxpayer's opinion about their activities constituting R&D activities would, in the absence of a finding by the Board, be determinative of this aspect of the taxpayer's eligibility to the tax offset refund."

The case gives voice to the notion that, in the absence of an Innovation and Science Australia Board finding, the Commissioner of Taxation is able to form his own view of the eligibility of a taxpayer's R&D activities.
This is an extremely worrying development as it suggests that the correct response to the BoT's Consultation Question 1 is that the roles and responsibilities of the two administrators have never been less distinct and less clearly understood.

Despite some public assurances by ATO officials that they don't seek to take a position regarding the eligibility of R&D activities, MJA has direct experience of the ATO doing exactly this. For example, as a result of being asked to assist in ATO R&D tax audits by taxpayers and advisers who are being subjected to a 'direct nexus' audit regarding their claimed R&D expenditure, we have seen extensive enquiries from the ATO regarding the R&D activities being put to the taxpayer. Further, we have seen adverse inferences about the eligibility of these activities being made by the ATO in Position Papers and Findings while still confining its decision to the expenditure issues. (These are not claims that MJA has prepared. We have been brought in as an expert adviser on claims prepared with the assistance of other tax agents.)

In these nexus audits, these adverse inferences are left standing without the R&D activities being reviewed or assessed by AusIndustry who is meant to have the relevant expertise and skills. It leaves taxpayers in a form of double jeopardy regarding the eligibility of the claimed R&D activities.

We submit that rectifying this situation should be a priority of the highest order for the BoT. This will deliver immediate benefits in terms of certainty and program integrity.

Recommendation 1: Introduce legislation to remove the power of the Commissioner of Taxation to form a view on the eligibility of R&D activities in the RDTI

Consultation Questions: Some Specific Analysis

Our analysis below seeks to illuminate some of the themes pursued in the Consultation Questions with a view to highlighting recent shortcomings in our experience that lead to suggested areas for improvement in regulator performance.

Inevitably, our analysis focuses on the problems, but we wish to emphasise that we have had excellent dealings with many AusIndustry and ATO personnel and that we believe that the administrative environment in which taxpayers are claiming and being assessed has improved markedly since the difficulties of the 2015-2019 'crackdown'.

In fact, we think that the program is well on the way to achieving its stated aims and some simple fixes in stakeholder interactions could result in the program regaining its once stellar reputation.

RDTI Roundtable – A Missed Opportunity for True Collaboration

(The comments we make here would also apply in no small measure to the State Reference Groups that are conducted by AusIndustry and the ATO.)

Since 2015, MJA has gone on the public record to repeatedly express its concerns about the decline in the consultation mechanisms surrounding the RDTI.

Kris Gale of MJA was a founding member of the R&D Tax Incentive National Reference Group (NRG) when it was established in the wake of the new RDTI. The NRG, jointly chaired by the ATO and AusIndustry, was made up of members drawn from the private sector, mainly tax agents and industry associations, and was meant to serve as the peak advisory body on issues relating to program delivery and administration.

After being put into an undeclared hiatus in late 2017, the NRG was replaced by the RDTI Roundtable in March 2019. The membership was doubled in size and some large corporates were added.

Key features of the new group include:

+ A third co-chair drawn from the private sector will conduct the meetings (This appears to have been dropped in recent meetings.)
+ No private sector member will be invited to all of the meetings but they are guaranteed at least one invitation per calendar year
+ AusIndustry and the ATO determine the agenda which is circulated shortly before the meetings. The agenda allows 10 minutes for 'Other Issues' at the end of the 2 hour meetings (By way of comparison, NRG meetings were scheduled for 4 hours.)
+ Members of the Roundtable who are not invited to a particular meeting are not notified of the fact that the meeting is taking place. (There was notification of the recent 1 September meeting sent out to non-invited members, following an enquiry made by MJA on 27 August.)
+ Minutes are not kept. Meeting Summaries are written up and eventually posted on the business.gov.au website. The summaries are not sent to members. They need to periodically check the website. (For the first time, notification of the posting of the 1 September Meeting Summary appeared in the 13 September RDTI eBulletin which means members could access them at the same time as the general public.)
+ Contact details of Roundtable members are not shared amongst the group

The RDTI Roundtable is not working. The cliché around these initiatives is that the Government is conducting a box ticking exercise. Sadly, the cliché is directly applicable here.

The lack of transparency of the mechanism is starkly apparent from the features described immediately above.
The sessions are turned over to a series of PowerPoints, presented by government officials, that contain information that could be emailed to members separately, thereby crowding out the opportunity for serious consultation and collaboration.

The variable domain knowledge of the members, some of whom have little direct involvement with the RDTI, mean that peripheral issues get ventilated whilst fundamental concerns are given short shrift. Examples of this are provided below.

MJA is particularly frustrated about the refusal of the administrators to truly consult with members that are seeking to make a meaningful contribution according to the Roundtable's terms Of Reference.

To provide one example of this frustration, at the first Roundtable meeting in March 2019, Kris Gale requested a sub-group to be formed to discuss the issues surrounding the eligibility of software R&D which has been a very vexed issue in the program. This request was supported by a number of members at the time and is evidenced in the relevant Meeting Summary. Such requests are contemplated in the Terms Of Reference: "Sub-groups may be used as required to consider specific proposals and issues".

The request was refused on more than one occasion. To MJA's knowledge, no Roundtable sub-groups have ever been formed to work on specific proposals and issues.

However, in recent months, it has come to light that AusIndustry and the ATO has conducted two workshops on software R&D, facilitated by the new Technology Council of Australia, involving a number of software companies. Again, to MJA's knowledge, beyond the TCA, no Roundtable members are involved in these workshops and the Roundtable is not being included in this exercise in any way. Put more bluntly, the RDTI's peak advisory body has been totally excluded from an exercise that Roundtable members first requested considerably more than 2 years ago.

Rather than speculating as to why the Roundtable is operating in the manner described above, before the goodwill in this critical consultative mechanism is completely eroded, there must be a comprehensive independent review of the operation of the RDTI Roundtable. If MJA's assertion that all genuine stakeholders have the program's best interests at heart, the Roundtable must be completely overhauled now.

Recommendation 2: An independent review be conducted about the constitution and operation of the RDTI Roundtable with a view to improving its vital contribution to the dual agency model

<u>AusIndustry – The New Registration Portal: A Critical Misstep</u>

On 5 July 2021, AusIndustry launched its new application portal. To date, we have used it for the registration of RDTI claims for the financial year ended 30 June 2021. We are not yet in a position to comment regarding other options such as applications for Advanced and Overseas Findings.

There was a round of consultations regarding the advent of the new portal held back in 2020. The rationale for the introduction of the new portal was outlined in the consultation notes as seeking to provide "a user-friendly and secure web-based portal, with an updated registration form to make it easier to provide the required information".

We have come to believe that the shift in emphasis in requesting information at an R&D activity, as opposed to a project level, was seen as an opportunity to introduce more flexibility for AusIndustry in the operation of the registration system. This would enable better use of options such as pre-registration reviews which we welcome, given the tendency of the previous system to register projects and activities, regardless of content, thereby facilitating questionable rebate payments and vexed audits down the track such as experienced in the 'crackdown'.

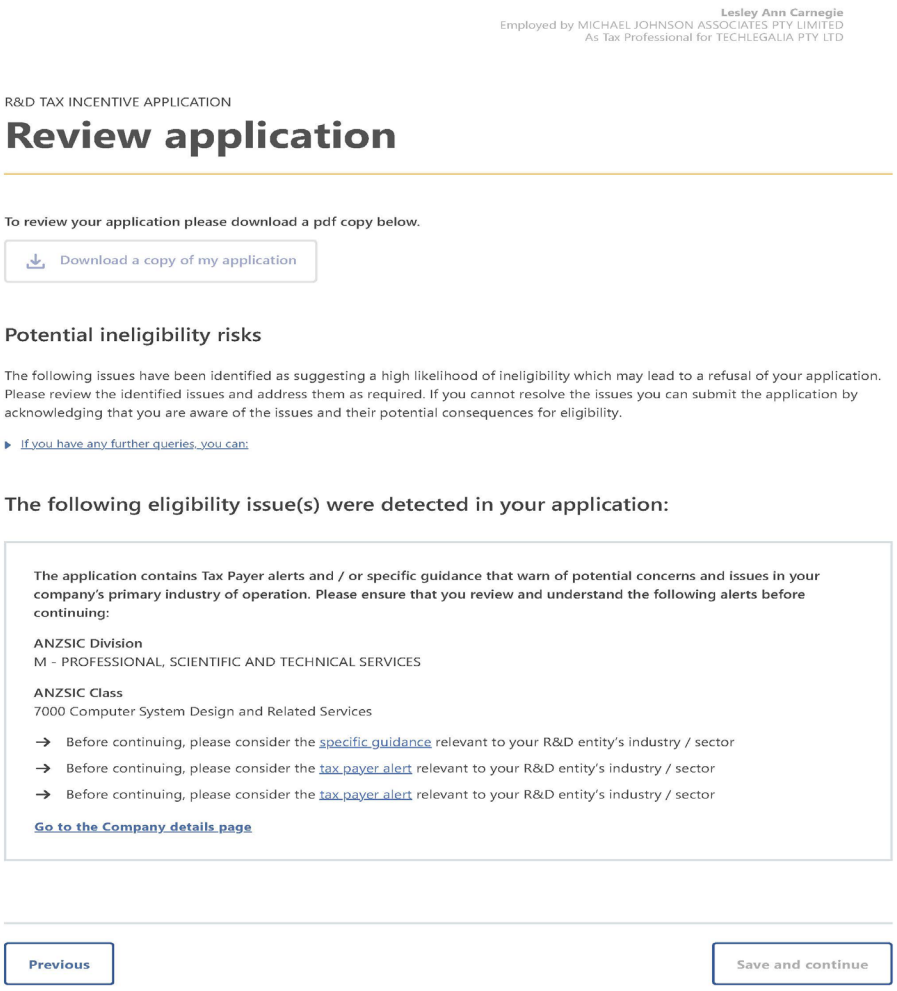
In support of that, MJA has spoken this month to one taxpayer who submitted via the portal and was subsequently contacted by AusIndustry and encouraged to withdraw its application due to clear deficiencies. The company was encouraged to have a "rethink' about what R&D to claim.

The taxpayer was very appreciative of the approach taken by AusIndustry and we do see this as the first evidence of a clear improvement in program delivery.

However, a far more pervasive concern has emerged in the early days of the portal. All our submitted applications have received in a warning message which requires a declaration that the taxpayer has read and understood highlighted AusIndustry/ATO guidance material related to the submitted R&D activities and that: **" The following issues have been identified as suggesting a high likelihood of ineligibility which may lead to a refusal of your application."**

We were receiving this message across all types of R&D activities that we were seeking to register on behalf of our clients – cancer research; biotechnology; software development; manufacturing etc.

Here is the Warning Message:



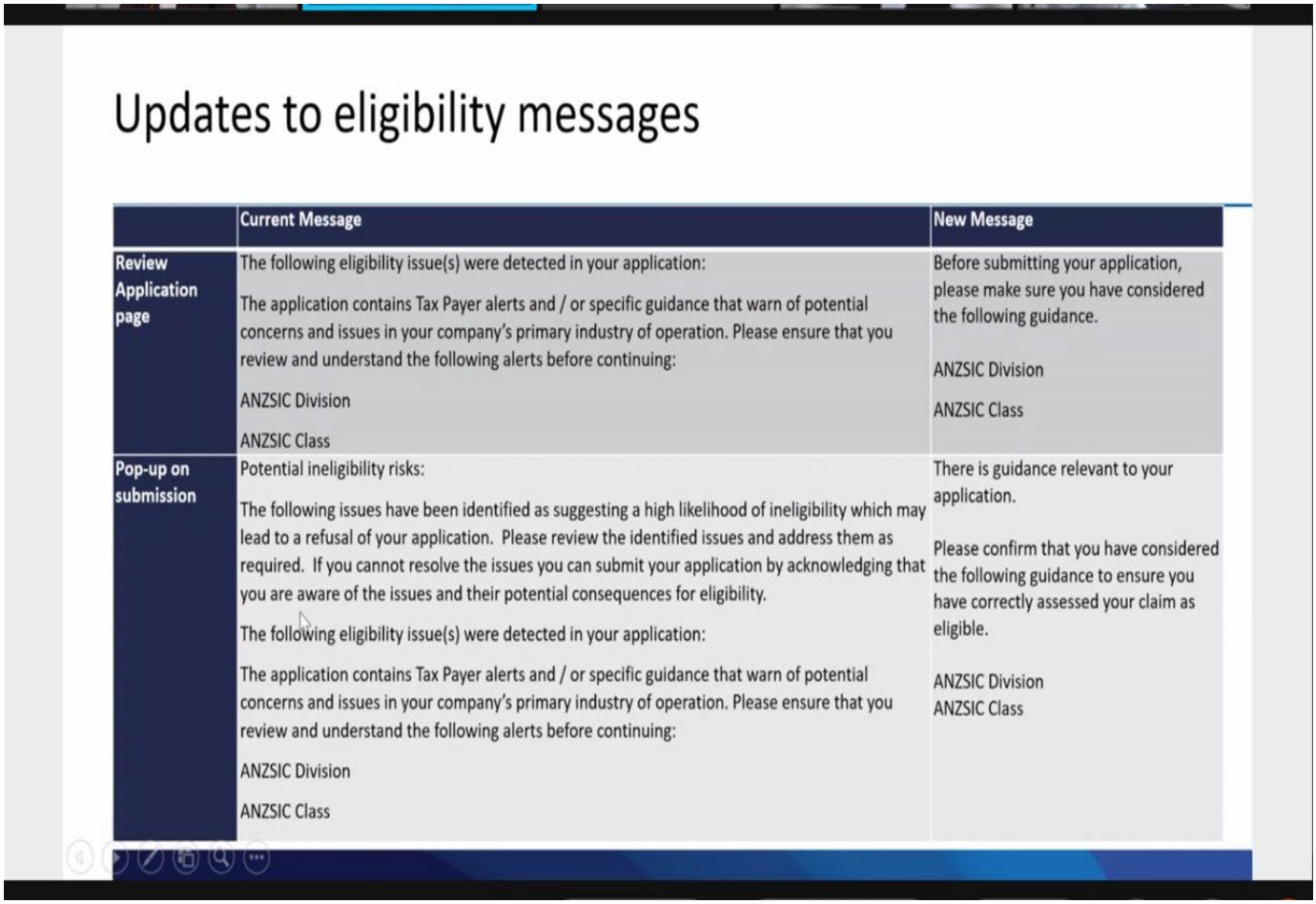
This message was not shown as part of the 2020 consultation sessions. MJA submits that, had it been presented to the attendees, it would never have been part of the portal launch.

In essence, it appears that there has been a confusion regarding the existence of published AusIndustry/ATO guidance. If a taxpayer selects an ANZSIC code in their registration application and it is the code relates to an industry that published guidance applies to, you automatically will see the warning message that your activities are "highly unlikely" to be ineligible. It is the ANZSIC code selected that generates the message. Not the activities described in the body of the application. Guidance exists in all the areas of mainstream R&D – medical technology, biotechnology, manufacturing, information technology, mining and minerals processing, agriculture, built environment. As it stands, virtually all claimants will receive this message.

MJA was able to establish the automatic nature of the message early on and, accordingly, we have been making the declaration acknowledging the potential ineligibility risks. As specialist practitioners, we were able to work this out. We shudder to think how the message has been received by self-prepared claimants and general tax agents with limited experience of the RDTI. It is a reasonable assumption that many will be deterred from claiming at all.

MJA contacted AusIndustry with our concerns in July and they have now been responded to.

The latest RDTI Roundtable noted that that language was a "touch too scary" and provided the following screenshot detailing the changes they intend to make to the eligibility messages:



	Current Message	New Message
Review Application page	The following eligibility issue(s) were detected in your application: The application contains Tax Payer alerts and / or specific guidance that warn of potential concerns and issues in your company's primary industry of operation. Please ensure that you review and understand the following alerts before continuing: ANZSIC Division ANZSIC Class	Before submitting your application, please make sure you have considered the following guidance. ANZSIC Division ANZSIC Class
Pop-up on submission	Potential ineligibility risks: The following issues have been identified as suggesting a high likelihood of ineligibility which may lead to a refusal of your application. Please review the identified issues and address them as required. If you cannot resolve the issues you can submit your application by acknowledging that you are aware of the issues and their potential consequences for eligibility. The following eligibility issue(s) were detected in your application: The application contains Tax Payer alerts and / or specific guidance that warn of potential concerns and issues in your company's primary industry of operation. Please ensure that you review and understand the following alerts before continuing: ANZSIC Division ANZSIC Class	There is guidance relevant to your application. Please confirm that you have considered the following guidance to ensure you have correctly assessed your claim as eligible. ANZSIC Division ANZSIC Class

The differences between the Current Messages and the new Messages are beyond marked. It would be reasonable to expect that these changes would be implemented in the application portal as a matter of urgency. Stunningly, this is not the case.

It was indicated at the Roundtable that changes in the application could not be made until November at the earliest. This has been confirmed in the 13 September eBulletin:

R&D Tax Incentive - eBulletin - September 2021 (mailchi.mp)

"The next release of the customer portal is expected in early November 2021. This will bring changes to improve your experience, including better support for multiple R&D entities, and an array of new help text, specific guidance and validation rules. The Department has listened to stakeholder feedback concerning the wording of warning messages and Tax Payer alerts and will look to address this feedback through the upcoming release."

This information hardly addresses the concerns of taxpayers and advisers not privy to the screenshot shared at the Roundtable. Many will not see the eBulletin at all and, of those that do, they can be excused for missing this article which is certainly not the lead story. Much of the damage will be allowed to continue unabated until November. This feels tantamount to an abrogation of the responsibilities that AusIndustry holds towards its registrants. These are the sorts of behaviours the BoT Review should highlight and seek to redress.

The failings in consultation, the ongoing secrecy surrounding the intended changes for most claimants and advisers and the pedestrian pace of the proposed amelioration of the problem all speak to administrative processes within AusIndustry that need to be reviewed in terms of approach, consultative mechanisms and timeliness.

The Warning Message has also highlighted the confusing nature of the guidance materials that the regulators are relying upon, both in term of applicability and content. If you click on the first link relating to the guidance referred to in the Warning Message screenshotted above, you are taken to the following page on the business.gov. au website:

Software development sector guide for the R&D Tax Incentive

Last Updated: 17 May 2021

Software development is critical and impacts all sectors of our economy.

Software development is critical to our modern economy and is undertaken across all sectors that access the R&D Tax Incentive.

Read our guidance materials to help you self -assess the eligibility of your software development activities under the R&D Tax Incentive.

Software activities and the R&D Tax Incentive

PDF · 0.48 MB DOCX · 0.15 MB

Draft Software Guide

A new and updated draft version of 'Software development activities and the R&D Tax Incentive' (Software Guide) was open for consultation from 17 May to 18 June 2021. You can still read the draft Software Guide at the Consultation hub.

If you submitted a response to our survey, we thank you. We are now reviewing feedback to incorporate into the final version of the Software Guide, which we will publish on this page in due course.

Taxpayer alerts

The R&D Tax Incentive is administered by us and the Australian Taxation Office (ATO). We share information about registrations and claims to ensure program compliance.

We prepare taxpayer alerts to provide a summary of the concerns about new or emerging higher risk tax arrangements or issues. The following taxpayer alerts is specific to the R&D Tax Incentive.

Based on its extensive experience in the field, MJA is able to interpret the contents of the page as follows:

In its registration application, the taxpayer needs to declare that it has read and understood the October 2020 Software Guide which can be accessed by clicking either icon immediately below the heading, **Software activities and the R&D Tax Incentive.** There is NO explanatory test provided to indicate that.

The 'Draft Software Guide' in the box is not applicable as it has not yet replaced the October 2020 document.

The Taxpayer Alerts, 2017/5 and 2017/5A – Addendum, were published 4 days apart on 20 and 24 February 2017. The Addendum was published in short order so as "*to further clarify when routine testing steps in software development projects should not be claimed and when they may be eligible R&D activities."* It softened some of the harsher language in 5A.

Again, MJA is across this history but this is a declaration that all claimants need to make that they have read and understood the relevant documents with regards to the software guidance. That is patently absurd.
A user could easily read the draft Guide in the box and miss the icons immediately above that take you the current October 2020 Guide. Reading and resolving the two Taxpayer Alerts that are, in part, contradictory and then offsetting that material against the subsequent October 2020 document is confusing for experienced practitioners, let alone companies who are submitting claims without external assistance.

There urgently needs to be a clear summary provided of what guidance products are on foot and a roadmap provided as to how they are to be read in conjunction with each other. A rationalisation of the applicable material is also required.

Recommendation 3: The AusIndustry/ATO guidance products on foot need to be clearly identified on the business.gov.au website. Clear instructions need to be provided as to which products are applicable and how they are to be used in conjunction with each other

<u>ATO – The Skewed Nature Of Timeframes And Expectations</u>

Since the RDTI has begun, a recurrent feature of the NRG and Roundtable meetings has been the often promised but seldom delivered guidance from the ATO regarding expenditure matters such as the apportionment of overhead costs.

A clear focus in ATO audit activity has been on overheads and apportionable costs in general. The ATO has challenged methodologies being used by taxpayers but it has failed to clearly document its views. At multiple NRG and Roundtable meetings, guidance has been said to be in train but has been delayed for reasons including lack of resources, other priorities and, in more recent times, COVID-19. At other times, the ATO has raised concerns that if they publish guidance, they are concerned that taxpayers will misuse it to justify making ineligible claims. These responses are generating enormous frustration for stakeholders, given the program is now more than 10 years old.

At the last Roundtable, the ATO indicated that it intends to update its website by the end the year but will not be providing Rulings in areas such as the apportionment of costs. This is a very concerning state of affairs.

This position of overall inaction continues to frustrate advisers and taxpayers and has raised anxiety levels amongst the innovation community.

More recently, the lack of timeliness in the ATO has been highlighted by its draft determination on the eligibility of R&D salaries connected to JobKeeper Payments: *Draft Tax Determination TD2020/D1 Income tax: notional deductions for research and development activities subsidised by JobKeeper payments*

The draft was announced on 27 July 2020 and stakeholder submissions were closed on 24 August 2020. Many of the submissions, including that lodged by MJA, took a different view to the Commissioner regarding the eligibility of the payments supported by JobKeeper. The draft has not been finalised more than a year later and now has direct impact on two years of RDTI claims.

Subsequently, the ATO released *Draft Tax Ruling TR 2021/D3 Income tax: research and development tax offsets - the at risk* rule. This was announced on 25 June 2021 and submissions were closed on 23 July 2021. At the last Roundtable, the ATO said that the earlier JobKeeper Determination can only be finalised, following the finalising of the Draft Tax ruling on the 'at risk' rule. Furthermore, it could not give a timeframe for the resolution of the two drafts. In the meantime, the ATO says that taxpayers should simply follow the drafts, no matter what views they legitimately hold.

The skewed nature of the relationship between the RDTI stakeholders is stark. Respondents get a month to table their views and they are then left waiting for an indeterminate and large amount of time. The disparity of the ATO's views and the shared views of respondents adds to uncertainty in terms of effective claim approaches and potential additional compliance costs. Uncertainty prevails over the matters throughout, yet the administrator moves at what can only be described as a glacial pace.

The problems highlighted above spill over into the speed and quality of AusIndustry and ATO risk assessments and audits. MJA has submitted on these issues in many forums previously and simply wishes to state that the improvements sought with guidance and consultation approaches should be echoed in these areas.

Recommendation 4: That consideration be given to an RDTI Charter that governs the interaction between stakeholders regarding matters of program design features and guidance. Clarification of timeframes and procedures surrounding risk assessments and audits should be included in the Charter

<u>The Need for Accountability</u>

One final comment that MJA wishes to make regarding the performance of the dual agency administration model relates to a narrative that has become increasingly apparent in recent years.

When taxpayers and advisers are at issue with the regulators, they are often being reminded of the option to settle the matters by litigation. This is not a systematic occurrence, but it is a concern if this is how the regulators formulate their attitudes to certain issues.

As the ASBFEO Report referenced earlier demonstrates, claimants of the Refundable R&D Tax Offset are smaller organisations with variable access to good tax advice and they are usually not equipped to undertake litigation.

Stakeholder relationships need to be built on cooperation and consultation, not on entrenched positions of an adversarial nature. We need to keep the administration of the RDTI, which is a non-compulsory benefits program after all, well away from the courts whenever possible.

This stems from all parties being accountable for their positions and actions. For the regulators to continue to play the litigation card in their interaction with taxpayers and their advisers will send the RDTI down a very dark pathway.

Recommendation 5: Stakeholders should define and publicly acknowledge their accountability in the proposed RDTI Charter

Summary Of Recommendations

This list of recommendations in no way seeks to be a comprehensive response to the BoT's Consultation Questions but is offered in the hope of making a positive contribution the Review.

Recommendation 1: Introduce legislation to remove the power of the Commissioner of Taxation to form a view on the eligibility of R&D activities in the RDTI

Recommendation 2: An independent review be conducted about the constitution and operation of the RDTI Roundtable with a view to improving its vital contribution to the dual agency model

Recommendation 3: The AusIndustry/ATO guidance products on foot need to be clearly identified on the business.gov.au website. Clear instructions need to be provided as to how to which products are applicable and how they are to be used in conjunction with each other

Recommendation 4: That consideration be given to an RDTI Charter that governs the interaction between stakeholders regarding matters of program design features and guidance. Clarification of timeframes and procedures surrounding risk assessments and audits should be included in the Charter

Recommendation 5: Stakeholders should define and publicly acknowledge their accountability in the proposed RDTI Charter

Next Steps

MJA looks forward to our involvement in the Working Group and to assisting in the delivery of the BoT Report scheduled for November.

If there are any questions regarding the content of this submission, please contact Kris Gale on 0411 171 596 or kris.gale@mjassociates.com.au

Yours sincerely

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