17 September 2021

Board of Taxation Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

By email: RandD@taxboard.gov.au

Attention: Mr Neville Mitchell and Mr Chris Vanderkley (Lead Reviewers - Board of Taxation)

Dear Neville and Chris

Review of the R&D Tax Incentive Dual Administration

Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to provide our submission to the Board of Taxation (BoT) on its Review of the Research and Development Tax Incentive (R&DTI) dual-agency administration model (the Review). CA ANZ equally welcomes the Review itself.

CA ANZ appreciated the opportunity to provide our verbal comments to the BoT in a video conference consultation meeting on Wednesday 18 August 2021, and our comments in this submission are consistent with and further to the matters covered in that meeting.

The R&DTI is jointly administered by the Australian Taxation Office (ATO), and the Department of Industry, Science, Energy and Resources (DISER) on behalf of Industry, Innovation and Science Australia (IISA), with the ATO being responsible for the administration and processing of R&D tax offset claims, and DISER/IISA responsible for registering companies' R&D activities. DISER/IISA are referred to collectively as AusIndustry in this submission.

The Terms of Reference for the Review include:

- gaining insights into taxpayers' experiences during the registration and claiming process, including their understanding of the different roles and responsibilities of the ATO and IISA in administering the program;
- analysing R&D administration models in other comparative jurisdictions and considering how the international experience may inform improvements to Australia's R&DTI dual agency delivery model;
- considering any new and streamlined processes undertaken by the two agencies in response to previous reviews of the scheme's administration, such as the Review of the R&D Tax Incentive (2016) and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) review (2019); and
- identifying the advantages and disadvantages of its recommendations, any potential financial impacts, and any trade-offs between simplification and/or reductions in compliance costs and the scheme's integrity.

Executive summary

- The success of Australia's innovation system, including the R&D program, will be a key determinant in our nation's ability to meet the challenges facing the world over the coming decade. Effective and efficient administration of the R&DTI is critically important for Australia's future economic, environmental and social prosperity.

- CA ANZ sought and obtained feedback in relation to the Review's terms of reference and consultation questions from CA member R&D stakeholders at a range of firms with large, mid-sized and boutique R&D practices.

- While there was no definitive consensus between members either in favour of or against a dual administration model, there was considerable consistency and correlation between the experiences our members reported having with the R&D program's administration. There was also a high level of alignment on the suggested actions that could be taken to make improvements based on principles that apply regardless of the administration model adopted.

- CA ANZ believes there has been, and continues to be, great value in AusIndustry being an administrator of the R&DTI. One aspect is AusIndustry's own purpose and objects, including its independent role in promoting the incentive to fulfill Australia's national and global innovation objectives. This is discussed in greater detail under paragraph heading *4. Accountability*.

- Given AusIndustry's long history with the R&DTI, the unique science, innovation and industry focus of AusIndustry, and the critical importance of certainty and stability for the program, CA ANZ considers that on balance, the dual administration model has merit and should be retained. But as this submission indicates, there are areas where administration must be improved.

- CA ANZ feedback from our CA members broadly falls into five (5) key themes:

    1. Roles and performance of the dual administrators
    2. Skills and competency of AusIndustry
    3. Interpretation and guidance by the dual administrators
    4. Accountability of AusIndustry
    5. Interaction with stakeholders in the program

- Key systemic administration issues identified relate to themes 1-3 above, while the root causes or enablers of the systemic issues seem to lie in the governance-related drivers in themes 4 and 5. For that reason, it is considered that the issues and problems identified could be solved by targeted actions, but will only be maintained under the current dual administration structure by addressing the governance-related recommendations relating to themes 4 and 5.

- Key administration concerns for themes 1-3 include:

    - Integration issues - duplication, inefficiencies and gaps between the dual administrators;
    - AusIndustry's actual or perceived deficiencies in technical understanding of projects and activities; and
    - Member experiences and R&D case law judgments indicating AusIndustry is taking an erroneous approach to interpretation and application of the law on "core R&D activities", as well as there being gaps in guidance from both administrators.

- Key targeted actions recommended to address the concerns in themes 1-3 include:
    - AusIndustry must be properly resourced and officers must be trained with the right technical skills and cultural mindset to do the role effectively;
    - Systems and processes between the dual administration functions ('activities' and 'expenditure' roles) must be better integrated;
    - Consider whether the New Zealand outsourced 'Callaghan' model, and its strategic 'advance' risk management approach can be incorporated; and
    - AusIndustry (IISA) must incorporate the latest judicial decisions on "core R&D activities" into its guidance and adopt a purposive approach to applying the law in its review process and findings.

- Key governance-related recommendations for themes 4 and 5 are:
    - AusIndustry (IISA) should be required to report under the Regulator Performance Framework (set Key Performance Indicators (KPIs), self-assess, account to stakeholders, and report to the Minister) and should establish an R&DTI Charter;
    - AusIndustry (IISA) should be held accountable to providing reasons for their decisions (not just the bare findings); and
    - AusIndustry should substantially overhaul its interaction with and treatment of R&DTI stakeholders to build a two-way relationship of trust, confidence and respect that is necessary for effective administration of the R&DTI.

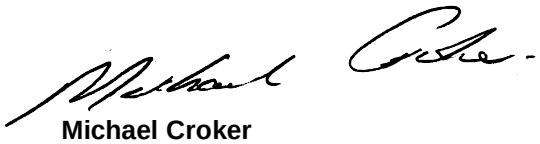
CA ANZ's detailed submission is contained in the Attachment to this covering letter.

We trust that the feedback and recommendations provided in our submission are of assistance to the BoT in its review of the R&DTI dual administration model.

CA ANZ has no objection to this submission being published.

We are available to discuss any aspects of the submission. If you have any questions or would like any clarification, please contact Donna Bagnall on (02) 9290 5761 or by email at donna.bagnall@charteredaccountantsanz.com in the first instance.

Yours sincerely



Michael Croker
Australian Tax Leader

Attachment A

Background and context

R&DTI policy reform

CA ANZ would like to begin our submission by making some initial comments by way of background to place the Review in the context of the broader R&DTI policy reform that has recently been undertaken.

The reason for this starting point is that the Review becomes even more significant and important when viewed in light of the substantial and substantive R&D tax policy measures that are now in place to encourage businesses to take the technical and financial risks of embarking on research, development, innovation and commercialisation activities in Australia. It is important to appreciate the nature of the R&DTI that is now available to businesses as financial support for undertaking activities that qualify for the incentive.

In October 2020, the Australian government legislated substantial changes[1] to enhance the R&DTI offering, which included:

- increasing the R&D tax offset rate for refundable offset claimants (aggregated turnover less than $20 million) to their corporate tax rate plus a 18.5% premium;
- increasing the R&D tax offset rate for non-refundable offset claimants (aggregated turnover $20 million or more) to their corporate tax rate plus a premium of either 8.5% or 16.5% based on two levels of incremental R&D intensity; and
- increasing the R&D expenditure threshold from $100 million to $150 million and making the threshold permanent.

This move followed many turbulent years for the R&DTI of policy uncertainty, program budget cuts, and proposals aimed at effectively restricting access to the R&DTI unless claimants could show almost unattainable levels of R&D intensity in their business expenditure. The R&D intensity proposals in the previous two iterations of the R&DTI Bills, together with several other aspects, would have had a deleterious effect on participation in the R&D program.[2]

CA ANZ made many submissions over the past five years expressing concerns about the expected impacts of those earlier proposals.[3] We were therefore very pleased to see the government ultimately listening to stakeholders and acting on recommendations about the nature and scale of the positive changes that were necessary to ensure the R&DTI provided a viable and value-for-money incentive into the future.

[1] R&D Tax Incentive Schedules 4–6 to the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020.* Enacted on 14 October 2020 as Act No. 92 of 2020 1 July 2021.
[2] Original and revised R&D intensity rates proposed to obtain R&D benefits the same or only slightly more than the current benefit were >5% or >4% R&D intensity, which was completely unachievable for most companies. While the entry level benefit for the more achievable 0-2% or 0-4% R&D intensity only offered 4.5c/$ benefit, which was almost half the current benefit and well below the marginal value of the incentive (i.e. the viable net benefit) after administration and compliance costs to claim the R&DTI. The net benefit would have been a mere 2.5c/$ after deducting 2c/$ which is known to be the average compliance cost rate.
[3] See for example, CA ANZ's submission to the Senate Economics Legislation Committee dated 16 March 2020.

The legislated R&DTI policy improves the tax benefit for small companies, and it retains the benefit at the same level at 8.5c/$ for large companies while also incentivising increases to R&D intensity with a generous 16.5c/$ benefit for those who can increase their intensity above 2%. This is a lot more realistic and achievable than the R&D intensity ratios originally proposed.

As a result of last years' reforms, the R&DTI has not only been maintained, but also substantially strengthened to offer a much more attractive, certain and internationally competitive incentive that will reward businesses for their R&D undertaken in Australia.

To ensure that these important R&DTI law reforms will achieve their policy objectives, it is now critical that the administration of the R&DTI be as effective as it can be.

In other words, now we have great policy, we need great administration. This is necessary to ensure that the R&D program operating here in Australia is a world-class tax incentive to attract and retain global capital. For this to occur, the administration model and execution of the administrative functions must be world-class - robust, efficient, equitable, and purpose-driven. This is essential to providing long-term investment-grade certainty of public investment supporting R&D activities.

Global-scale disruption drivers and grand societal challenges

Another dimension highlighting the importance of the BoT's Review of the R&DTI is the context of the massive drivers of disruption facing Australia and the world.[4] Many drivers of disruption pose "grand societal challenges", including:

- the multi-faceted and accelerating risks and opportunities of the climate emergency, e.g. clean energy, resilient infrastructure, food and water security;
- the COVID-19 global pandemic response and recovery, e.g. medical solutions such as vaccines, treatments, diagnostics and technologies;
- the rapidly aging population, e.g. healthy aging, workforce participation and associated fiscal (revenue and expenditure) impacts; and
- globalisation and the growing role of emerging economies, e.g. international competitiveness and global trade and market trends.

In a new era of "mission-oriented" innovation policy, governments around the world are seeking to redirect technological change from existing trajectories towards more economically, socially and environmentally beneficial technologies to align with the Sustainable Development Goals (SDGs). The world's collaborative response to COVID-19 illustrates what can be achieved by mission-based global innovation systems. Australia's national innovation system must be positioned to benefit from the international Science, Technology and Innovation (STI) supply and to address the SDG demands. This will involve Australia continuing to link our national innovation system through the three-pillar framework for international STI collaboration: ***build*** national capacity, ***boost*** international flows, and ***broker*** coalitions.[5]

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[4] OECD Science, Technology and Innovation Outlook 2018, 'Adapting to Technological and Societal Disruption', 19 November 2018 and OECD Science, Technology and Innovation Outlook 2021: Times of Crisis and Opportunity, 12 January 2021.

[5] United Nations Inter-Agency Task Team on Science, Technology and Innovation for the SDGs, *Guidebook for the Preparation of Science, Technology and Innovation (STI) for SDGs Roadmaps*, September 2020, pp 46-50.

The private sector is the main actor in technology and innovation supply to meet the global demand, and "the main way that technology and innovation are disseminated [internationally]… is through market mechanisms such as the import of manufactured goods (particularly capital goods and technology intensive intermediary goods), technology licensing, foreign direct investment, ICT and commercial services, patents and trademarks, and training in engineering and management".[6]

One SDG in particular, SDG13 - Climate action, represents a major imperative and opportunity for Australia to lead in meeting the domestic and global demand for zero carbon solutions. Australia has one of the most carbon-intensive economies in the world, but is also the continent with the highest quality solar and some of the world's best wind resources.[7] As former investment banker and a founding director of the Clean Energy Finance Corporation Anna Skarbek has stated, achieving net zero requires dialling up progress on the known technologies and "vastly scaling up carbon sequestration through forestry to buy us time to also ***scale up the research and development for the residual emissions***".[8] This emissions reduction challenge is described by some as the 'Final 25%'.[9] No part of the economy can afford to be going slower than it can go on decarbonisation if the Paris Agreement commitments are to be achieved.

The R&DTI offers an economy-wide mechanism through which innovative companies can receive vital public financial investment in their endeavours to develop solutions or technologies to transition their own or their customers' products and process into the most lucrative parts of the global innovation race.

Exponential growth sectors this decade will include advanced manufacturing, information and communications technology (ICT), energy sector innovation such as renewable energy and storage systems, clean transport technology and infrastructure, and zero-emissions industrial processes, and regenerative agriculture, biodiversity and ecosystem services.

Within each of those sectors, software R&D has already established itself as the central enabler and integrator given its role in connectivity and communications involving smart technologies, digital platforms and marketplaces, users, fintech, data, analytics, research, Artificial Intelligence (AI) and the internet of things in a wide range of applications. Similarly, software R&D will be transformative for clean energy by enabling renewable energy generation and storage to be integrated with consumer assets and technologies, such as homes and electric vehicles, to create reliable multi-directional distribution and transmission networks with consumer participation benefits.

Australia has immense potential to thrive in this new era.

In this context, the role of a successful R&DTI program incentivising research, development, innovation, commercialisation and public/private collaboration has never been more important.

Effective and efficient administration to ensure investment grade certainty, minimisation of delays and disputes, and maximisation of market participation are absolutely critical components of the national R&D system. The administration of public financial support for R&D, grounded in a purposeful, mission-based mindset, represents work of enormous importance this decade. The R&DTI administration model must therefore be fit-for-purpose so that it is up for the task.

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[6] Above, n5, p. 46.

[7] Australian Government, Geoscience Australia, 'Other Renewable energy resources'.

[8] 'Australia's electricity market must be 100% renewables by 2035 to achieve net zero by 2050 – study', article by Katharine Murphy, published by the Guardian, 26 February 2020.

[9] 'The Final 25%: How to tackle hard-to-reach emissions', Nanowerk News, 5 August 2021.

CA ANZ's approach in preparing this submission

Following announcement of the Review in May 2021, CA ANZ co-ordinated and conducted several workshop-style and one-on-one conference calls with CA members from a range of firms that have large, mid-sized and boutique R&D practices. The purpose of these conference calls was to discuss their feedback on the consultation questions, within the scope of the terms of reference. After collating the feedback received from members, CA ANZ analysed and distilled their feedback and comments into common themes.
In drafting this submission, we have been mindful of and have sought to address the majority of the Consultation Questions as they were relevant in the discussion under each of the **common themes** below.

The Consultation Questions were:

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?

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?

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.

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

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?

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

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

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?

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

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)?

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?

Submission - Common themes

From our analysis of the feedback received from members, CA ANZ found that while there was no definitive consensus either in favour of or against a dual administration model, there was overwhelming consistency and considerable correlation between the experiences our members reported having with the program's administration.

There was also a high level of alignment on the suggested operational and governance-related principles that should apply, as well as the actions that could be taken to make improvements regardless of the model adopted.

Nevertheless, many CA members and CA ANZ believe there has been, and continues to be, great value in AusIndustry being an administrator of the R&DTI. Underpinning this view is our support for AusIndustry's own purpose and objects, including its independent role in promoting the incentive to fulfill Australia's national and global innovation objectives. This is discussed in greater detail under 3 and 4. below.

Given AusIndustry's long history with the R&DTI, the unique science, innovation and industry focus of AusIndustry, and the critical importance of certainty and stability for the program this decade, CA ANZ considers that on balance, the dual administration model has merit and should be retained. But improvements are needed.

Our feedback from members broadly falls into five (5) key themes:

1. Roles of the dual administrators
2. Skills and competency
3. Interpretation and guidance
4. Accountability
5. Interaction with stakeholders

We now discuss each of these in greater detail.

1. Roles of the dual administrators

In relation to whether the roles and responsibilities of the two administrators (ATO and AusIndustry) are distinct and clearly understood, the separate roles are not necessarily understood by new entrants to the system. However, members report that they spend the appropriate/considerable time explaining to their clients the roles of the dual administrators and their respective functions within the R&D program so that they understand the system.

The role definition is in one sense distinct – AusIndustry registers and determines *activities*; ATO reviews and determines *expenditure*.

However, in practice, in order to apply the law, the distinction or line is blurred.

There is inherent overlap in the middle of the two roles because there is the nexus test – the question is - is there *expenditure incurred on R&D activities*? It is a function of the need to ascertain the relationship between the expenditure and the activities.

In addition, in the recent case of *Commissioner of Taxation v Auctus Resources Pty Ltd* [2021] FCAFC 39, comments made by the Full Federal Court in *obiter dictum* expressed the view that the Commissioner may form his own views about the eligibility of R&D activities under his general power of administration. He does not need an AusIndustry finding to determine that an R&D entity's activities are ineligible R&D activities. This has further blurred the distinction, despite being arguably the correct position. However, the very potential that the Commissioner could deny the eligibility of *activities* in the absence of an AusIndustry finding illustrates the importance of AusIndustry's processes adequately dealing with the matter. As this function is one for which AusIndustry has primary responsibility, it should be administered at the appropriate time during AusIndustry's part in the overall R&D claim system.

CA ANZ considers that it is one thing to know that the Commissioner can question and refer 'activities' back to AusIndustry during an ATO review years after the claim is made. However, it is another thing entirely for the Commissioner to feel the need to actually make the determination himself if AusIndustry has not made a positive finding. This is especially if this is something that is or risks becoming the norm. This situation should be the exception rather than the rule.

In other words, AusIndustry should be performing the task effectively as part of its functions, so that the Commissioner, in principle and practice, does not need to.

The bigger existing problem is that the process and system is not efficient when something goes wrong and activities are queried by the ATO.

On the topics of registration, eligibility review and compliance arrangements which impede or hinder dealings with the current administration system, the feedback offered numerous insights which we now discuss.

1.1 Review of eligibility of activities

A significant concern with the two administrators is the double-handling when the ATO queries the eligibility of activities. The complaint is the inefficiency and duplication of having the two administrators involved in this review process.

Normally, the registration aspects are straightforward, followed by making the R&D claim via the tax return. Subject to comments below about some issues with the new online registration portal, the registration process itself is not a major concern. There is also no real problem that there are two administrators involved, but it is when something goes wrong that the problems start. Therefore, the concern is with aspects following and outside of the registration process.

To our mind, this means that either –

(i) The system must ensure that AusIndustry must do more upfront to make a positive finding and/or provide greater assurance that activities are eligible – this will require better funding and resourcing for AusIndustry, or

(ii) The subsequent review / audit process by the ATO needs to ensure at some point (as soon as possible in the process) that the two administrators are brought together and joined in the proceedings and bound by the one decision.

The first option is to be preferred: that is, the prevention rather than curing administration inefficiencies. Members' feedback to CA ANZ suggested that their experience is that out of every 100 cases the ATO refers back for review of eligibility of activities, AusIndustry would only review approximately 20 of them – 20%. It therefore seems that AusIndustry has too little capacity to do the job that it has conferred on it, i.e. its primary function. AusIndustry needs to be properly skilled and resourced because it will be letting down the system, and causing downstream issues, if it has a core function and policy objectives that it is not addressing on a timely basis and in a competent and professional manner.

To use an analogy with production lines, AusIndustry's administration approach has been causing bottlenecks and what appear to be 'quality control' problems in the system that the ATO has to monitor and reject (i.e. if AusIndustry is leaving 80% of potential 'quality control' issues to go through to and/or remain the problem of the ATO to deal with). Instead, AusIndustry should have a robust 'quality review' process in place to perform that function and remove the need for the ATO to perform it.

In relation to any differences experienced in the way the program has been administered in response to previous reviews, the feedback received has been that there have been both new and additional challenges experienced, and some areas of improvement.

We note that Recommendation 6 of the Review of the R&D Tax Incentive (2016) was:

- That the Government investigate options for improving the administration of the R&D Tax Incentive (e.g. ***adopting a single application process; developing a single programme database***; ***reviewing the two-agency delivery model***; and ***streamlining compliance review and findings processes***) and ***additional resourcing that may be required to implement such enhancements*.**

- To improve transparency, the Government should also *publish the names of companies claiming the R&D Tax Incentive and the amounts of R&D expenditure claimed* (Sections 5.1- 5.5, p. 45)

As our examples above and below indicate, the Review Panel's recommendation for "*streamlining compliance review and findings processes*) and *additional resourcing that may be required to implement such enhancements*" is a very important one, but is yet to be implemented effectively. In fact, since 2016, the reported experiences with the compliance review and findings processes appear to have become worse. However, improvements have been reported more recently since the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) R&D report in 2019.

Changes at AusIndustry

The feedback CA ANZ has received is that, since the ASBFEO's report, AusIndustry's approach to compliance activity has improved substantially.

There was a rapid change in AusIndustry's processes and attitudes, and compliance activity has significantly dropped across all sectors. This pause on compliance action *may* be a good sign that AusIndustry now understands the importance of site visits to ensure that officers apply their STI technical skills and knowledge properly based on a full visual inspection and understanding of the R&D activities being undertaken.

The 2017/18 financial year was the most active year for claimants receiving letters stating that they had been selected for risk assessment. Prior to the ASBFEO report, desktop audits conducted by way of written responses and refusal to do site visits was commonplace. Some AusIndustry officers seemed to display an attitude of indifference or a complete lack of accountability in terms of the need to explain their decisions. Internal reviews did not seem to be conducted independently. Rather, reviews were just supplementary to the original decision-maker's view.

The BoT should seek to understand the changes made in AusIndustry which reduced the level of compliance activity to determine whether they are permanent improvements, or just AusIndustry pausing all compliance activity which is going to create future backlogs when the ATO queries them.

1.2 Integration issues

AusIndustry and ATO systems need to talk to each other and be more automated to close the gaps between the two administrators. Otherwise, decisions are being made by AusIndustry, and then the claimant and agent are expected to contact the ATO themselves to ensure that the ATO is told, and so that ATO enforcement or other steps are not taken independently of the AusIndustry process.

Three examples were shared with CA ANZ:

(i) *Internal review* – "AusIndustry issued a finding saying activities were not R&D and the company was going through an internal review route with AusIndustry. AusIndustry then lets the Commissioner know that the activities are found not to be R&D. But the claimant is also then meant to let the Commissioner know that they are appealing it and obtain for example a "50/50 agreement" pending the outcome of the appeal. Otherwise, the ATO gives the company 30 days to ask the ATO for an amendment and if not, the ATO treats it as an involuntary amendment and issues an assessment with penalties. And then it goes to debt collection, all while AusIndustry's internal review is still occurring."

(ii) *ATO audit / AusIndustry review* – "An audit and review can have a duration of more than two years. There are significant costs associated with two parallel review processes. Review processes should be joined together as early as possible. The suggestion is that there should be a maximum statutory limit."

(iii) *Advance Finding variation* – "If a claimant goes to put in a variation with AusIndustry for an Advance Finding, they are asked to revoke their Advance Finding rather than amend it. But because of this they are not sure that the ATO will accept their R&D claim now because they now have a new finding number and the Advance Finding has a later date. This can mean that the finding is no longer in advance of when the expenditure was claimed, as is required."

Claimants should not find themselves the victim of duplicative, overlapping powers of the dual administrators. Nor should they fall through the cracks between the two administrators whose **systems should be integrated and seamless.**

There were further examples of interaction problems:

(iv) *Substituted accounting period (SAP)* – "When a claimant applies for registration, AusIndustry will ask for a letter from the ATO regarding approval of a SAP. However, the ATO letter takes 28 days, whereas the systems should talk to each other and be a streamlined, seamless, integrated process."

(v) *Justified Trust and R&D* – "The ATO refuses to give any assurance on R&D, so it is excluded from the scope of Justified Trust because of AusIndustry's involvement. Therefore, a company can only get an "amber light" in the Justified Trust report simply because they have an R&D claim as part of their tax affairs."

Then there were examples of unacceptable and unprofessional service timeframes and inflexible / impractical administration:

(vi) *Advance Overseas Findings* – "AusIndustry is taking anywhere from 4 months to 12 months to provide a decision to claimants. A one-year turnaround is extremely poor and unworkable."

(vii) *Substantiation and record-keeping requirements* – "The ATO and AusIndustry are overly prescriptive about what needs to be expressly written on records for the activities to be R&D. They should be practical and commercial, and work with natural systems. It should be more about substance, not form."

The feedback from CAs also indicates that the ATO has a highly suspicious mindset when it comes to R&D.

1.3 Registration process

The application process itself is in the process of being improved by AusIndustry through the development and implementation of the online Customer Portal.

Early feedback from claimants and R&D practitioners has been that the portal is displaying off-putting, disconcerting and poorly worded warning messages to claimants that:

> "**The application contains Taxpayer 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."**

Other messages go even further and provide a warning to the effect that it is "highly unlikely" that a company in the claimant's *sector or field of business* is undertaking eligible R&D.[10] It appears that this is due to the choice of ANZSIC code being selected by the claimant. For example, if a claimant lodges a software claim, and chooses:

> **"ANZSIC Division J** - INFORMATION MEDIA AND TELECOMMUNICATIONS,
> **ANZSIC Class 5700** Internet Publishing and Broadcasting"

In AusIndustry's latest R&DTI eBulletin, they confirm that they are working on resolving these issues for the next release of the Customer Portal in early November 2021, saying:

> "This will bring changes to improve [claimants'] 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 Taxpayer alerts and will look to address this feedback through the upcoming release."

AusIndustry's eBulletin should have shown a screen shot of the actual warning messages so that claimants were clearly alerted to the message in question, what this meant for their claim, and how AusIndustry was dealing with it.

[10] There have long been concerns that some officials in both AusIndustry and the ATO have a closed mind when it comes to accepting that R&D is possible in some traditional, long-established sectors.

Given that all new R&D applications must now go through the online portal, and this issue will not be resolved for a period of four months after the problem arose, it is of concern that most claimants will likely receive this warning message and may be deterred from lodging their R&D claim. CA ANZ is not aware of whether the Customer Portal development work will achieve a "single application process" and "a single programme database", however that should be the objective being pursued by the dual administrators.

The BoT may wish to investigate the collaboration that exists between the two agencies on the portal.

We also note that the amendments to the R&D tax legislation in 2020 included a new administrative measure relating to the publication of claimant data. The intention of the change was to enhance the transparency of the R&DTI and align it with other programs where details of recipients of public support are disclosed publicly. The ATO is responsible for publication of the claimant data. The first year of claim data published will be for claims made for financial years commencing 1 July 2021 (FY22). The ATO must publish details within 2 years following the end of this period. The details published will be the name of R&D entity; ABN; and amount of R&D expenditure claimed, net of feedstock adjustment.

CA ANZ suggests that data of this nature should be housed in the "single programme database" once developed.

2. Skills and competency – Technical and soft skills

The second theme relates to the technical skills and competencies of the dual administrators, and the soft skills.

AusIndustry's role involves findings on eligible activities. This means a need for a proficient level of technical skills and competency in the field of science, innovation, engineering, mechanical and technological processes, etc in an industry and commercial context, i.e. 'STI technical'.

The ATO's role involves findings on eligible expenditure. This means a need for a proficient level of technical skills and competency in the field of the taxation legislation and tax administration legislation, i.e 'Tax technical'.

The feedback from CA member R&D practitioners is that there is a perceived technical deficiency with AusIndustry at the level of the officers conducting reviews. This means that technical understanding of R&D projects and activities is not seen as being up to the standard expected by applicants and other stakeholders.

It is neither possible nor appropriate for this submission to cite specific examples shared by members, however what can be said is that such deficiencies should not be the reality (or at least the perception and the feedback) after 36 years of the R&D program under AusIndustry (the R&D Tax Concession was first introduced in 1985), and on the 10th anniversary of the current R&DTI which occurred last week. It is not good for the R&D program however it is viewed.

Based on the feedback, it seems that a significant part of the problem relates to the need for AusIndustry officers to have:

(i) A broad-based solid, general-level of STI technical skills and competencies (but not "rocket-science-levels" of STI technical); and

(ii) Soft skills consisting of a culture of accountability to the 'good governance' principles recommended by the ASBFEO (discussed in 3.2 below). That is, committed to living those values of being fair, consistent, educative, customer-focused, practical, proportionate to the business/claim, and above all having a mindset tied to the purpose of the R&DTI – that it requires a ***beneficial and commercial approach, consistent with the text and objects for the purpose of encouraging research and development in a commercial setting.*** This is discussed in 3.3 and 4.

Achieving this is about recruiting the right people, training them properly and embedding the right culture at AusIndustry - from the top down.

Indeed, the BoT may wish to delve into people and culture issues in the R&D functions at both AusIndustry and the ATO.

Software

In relation to software in Australia, the feedback is that AusIndustry's knowledge of the ICT industry and understanding of software development projects is extremely lacking. This reality or perception may be due to a combination of the two factors discussed above.

Following a range of complaints from small businesses, the ASBFEO conducted a Review of the Research and Development Tax Incentive (R&DTI). The review comprehensively investigated the experiences of small and family businesses that have claimed the R&DTI. The ASBFEO report 2019 recommended that "this important incentive be retained and a suite of reforms made to the way the system is administered." (p.4)

In its press release, the ASBFEO said that: "Our report found there has been a shift in the interpretation of the R&DTI legislation, narrowing the focus and leading to more claims being rejected, particularly in the area of software innovation. Both the ATO and AusIndustry have heard these concerns and have pledged to update their approach to R&DTI compliance checks to ensure better communication, guidance and education."

The ASBFEO's report is revealing and includes by way of evidence of this a detailed "analysis of the R&D legislation and application of the 2015 Frascati Definition to R&D in the development of software" at Attachment B, as well as an analysis of AusIndustry's failure to date to consult on the implications of the landmark *Moreton Resources* Federal Court decision on the scope of "experimental activities" for the "purpose" of generating new knowledge in the form of new or improved materials, products, devices, processes or services, at Attachment C of the report.

As set out in the ASBFEO's report: "the Full bench of the Federal Court decided in favour of *Moreton Resources* and agreed that the application of the law by ISA was incorrect. This was because ISA was incorrect on the nature of the tests to determine what is R&D and it was wrong on limiting the purpose of R&D to ignore that the new knowledge can be in the experimental development of materials, products, devices, processes or services." (Attachment C, p. 41) This administrative concern is discussed further below in theme 3 – Interpretation and guidance.

There is a confluence between AusIndustry's STI technical capacity/culture and its legal interpretation of the law, and it is difficult to dissect and identify where the exact problem is. Both impact the application of the R&D provisions relating to eligible activities, so both must be properly addressed.

It appears to CA ANZ that AusIndustry has in recent years been categorising software innovation primarily as "non-R&D innovation" which is not eligible R&D. Yet, the ASBFEO's findings indicate that AusIndustry's administration has been actually excluding eligible software R&D. As noted previously in this submission, developing a successful ICT sector in Australia will be a critical part of realising future economic success and international competitiveness.

AlphaBeta's report commissioned by AusIndustry (IISA) in 2020[11] also illustrates that before Australia's R&D intensity will substantially increase, the Australian economy will need to attract, create and establish those higher-R&D intensity sectors, such as ICT and advanced manufacturing in Australia. At present, it is a huge opportunity-cost, as Australia invests more in R&D than our global peers do in many sectors, but we are not competing as intensively in the most lucrative parts of the global innovation race.[12]

The New Zealand model

By comparison, when we compare the **NZ R&D administration model**, the feedback has been that in dealing with New Zealand (NZ) officials on clients' software R&D claims, they were pleasantly surprised by how good the understanding of the industry and the experience was. NZ outsources the technical side of R&D tax incentive administration to Callaghan Innovation, New Zealand's Innovation Agency, the private sector group who administer the Innovation Grants program. Therefore ostensibly, there is a professional level of STI technical understanding embedded in the NZ R&D tax incentive administration. The feedback included that the NZ Inland Revenue (IR) eligibility review process was fair and equitable, as the IR proactively told the software claimants which amounts they were entitled to claim, and only applied changes of view prospectively.

In addition, in NZ, significant claimants receive a 'governance review' upfront and an audit upfront, and then the "green light". This early assurance manages risks of the program and provides certainty and confidence in the program for claimants. This is an example of a sensible risk-management and process improvement strategy that AusIndustry should be considering how to adopt and implement.

The ASBFEO's 2019 report recommended that this approach be adopted by AusIndustry for first year claimants who are small businesses. (p.6) However, this is equally important for larger claimants if we are to eliminate or minimise the kind of systemic duplication, compliance cost, and process inefficiency/bottleneck issues raised in theme 1 above.

AusIndustry must be properly resourced so that it can implement the necessary upfront 'governance review' and audit strategy and improve its STI technical capacity and culture.

To complement this, the ASBFEO also recommended that for small business claimants, "statutory examinations by AusIndustry should not be retrospective beyond one year unless fraud or intentional disregard of the law is reasonably suspected." (p.6 - Recommendation 3a.)

3. Interpretation and guidance – Application of the law

The third theme is about the interpretation and application of the law by each of the administrators, from their different perspectives.

[11] AlphaBeta, Australian Business Investment in Innovation: levels, trends, and drivers, 20 January 2020.
[12] AlphaBeta, n 11 above, p. 3.

AusIndustry's role is to interpret and apply the R&DTI provisions from the perspective of whether activities constitute eligible "core R&D activities" and "supporting R&D activities" in sections 355-25 and 355-30 of the *Income Tax Assessment Act 1997* (ITAA 1997). This is for the purpose of AusIndustry registering those eligible R&D activities under section 27A the *Industry Research and Development Act 1986* (IR&D Act).

The ATO's role is to interpret and apply the R&DTI provisions from the perspective of whether there is eligible expenditure incurred on R&D activities, under section 355-205 of the ITAA 1997. This includes ensuring that other conditions under the tax law are satisfied.

Both AusIndustry and the ATO could improve on their interpretation and guidance, however AusIndustry's approach is causing the greatest concern.

3.1 Key feedback and concerns

The key feedback and concerns raised regarding the ATO guidance was:

- ATO expenditure guidance on overhead allocation is long overdue, despite this being promised for the past decade since the new R&DTI was introduced in 2011. This guidance used to exist under the old R&D Tax Concession pre-2011, however it was never replaced under the R&DTI for some unexplained reason. It is necessary for claimants to have certainty around acceptable approaches to apportionment of indirect expenditures. CA ANZ and other stakeholders have consistently asked for this guidance, at nearly every national R&D Roundtable meeting since this forum was established. It is very difficult for claimants to follow the ATO's overhead allocation method if the tax regulator does not publish it.

- ATO determination on the interaction between the 'at risk' provisions and JobKeeper payments (TD 2020/D1) – CA ANZ prepared our submission urgently in July/August 2020, along with other stakeholders, and then we heard nothing from the ATO on it for almost a year. No formal or informal feedback or compendium was released. The determination remains in draft, despite taxpayers needing to apply it. The ATO has since issued a new draft ruling on the 'at risk' rule generally (TR 2021/D3), adopting the same views but inconsistently between the two drafts. There is general discontent amongst stakeholders with both drafts. In maintaining its views, the ATO seemed to reject or ignore all of the points raised in CA ANZ's submission, which identified 10 areas where the tax regulator's interpretation and application of the law was disputed.

The key feedback on AusIndustry's guidance included:

- AusIndustry guidance has improved slightly in the past year or so since the ASBFEO's report, e.g. The R&D Tax Incentive *Guide to Interpretation*, updated in November 2020. However, there are still problems as it has not yet been updated to include the latest case law such as *PKWK* (e.g. the guidance states that there must be a substantial purpose to generate new knowledge (p.15), which the Tribunal rejected). Furthermore, it remains to be seen whether AusIndustry will continue taking an overly narrow interpretation and application of the law. The interpretation and application of the law in recent years seems to have been driven by some other rationale for narrowing the program, such as budgetary pressures from government. Compared with the very early years of the R&DTI, there has been a marked change in AusIndustry's approach observed and experienced by claimants and stakeholders, despite there being no law change to the definition of R&D activities (as confirmed by the ASBFEO report, see p. 26 and Attachment B regarding software). This interpretation approach is discussed in greater detail below under 3.2 and 3.3.

- AusIndustry guidance needs to be able to be relied upon, and needs to be more practical, useful and provide better examples or actual findings. Consideration of different forms of guidance such as ATOID-style guidance has merit. However, it should also be noted that ATOIDs cannot be relied upon to bind the Commissioner. The ASBFEO recommended that AusIndustry should "better utilise advance findings through their wider promotion, expediting processes and publicising decisions". (p.6, Recommendation 3c.) This should be complemented by the strategic risk management processes and upfront governance reviews discussed above.

3.2 Administrative law and good governance principles

As noted above, **the greatest concern of R&D stakeholders has related to the way in which AusIndustry has approached its interpretation and application of the law in recent years**. The task of interpretation is not simply ensuring that others comply with the law. That is, it is not just about enforcement by the administrator against those who are subject to the law. Interpretation is as much about compliance with the law *by the administrator*, i.e. administration in accordance with the rule of law, natural justice, and principles of best practice administration. General administrative law principles require that executive decision-makers exercise their statutory powers pursuant to the principles of Equity (i.e. decisions must be made in accordance with the law, be fair (equitable), reasonable/rational/proportionate and intelligible[13]).

Consistent with these administrative law requirements, the ASBFEO recommended that there is a need to embed what they described as 'good governance' principles into R&DTI administration. The ASBFEO stated that "good governance of any government program is characterised by:

- Transparency, consistency and clarity of operation and a reciprocity of behaviour expectations (the agencies should engage with small business in the same way and within the same timeframes that they expect of small business).
- Fairness (intuitively sensible, with a culture of a level playing field).
- A proportionate approach (providing a nuanced response to the particular circumstances of the small business taxpayer).
- Value for the customer/taxpayer experience.
- An educative approach to the program's integrity.
- A modern approach to compliance is also proactive and involves professionalism and industry collaboration." (p.10)

Overall, the ASBFEO identified that there needs to be:

- A fairer, more consistent, more-educative and more customer-focused approach by both AusIndustry and the ATO (p.5); and
- Practicality given commercial reality/industry context and proportionality having regard to the complexity and size of the business/claim (p.6).

[13] French, Justice Robert, "The equitable geist in the machinery of administrative justice" (FCA) [2003] FedJSchol 9

The ASBFEO expressed that they had "grave concerns that the administration of **the program does not provide sufficient certainty** for small businesses". The harshest impact of this uncertainty is that compliance activity years after the incentive is claimed can significantly impact the continued viability of businesses, particularly small business claimants. (p.5)

The same thing can be said of the program for all sizes of business.

Uncertainty

Uncertainty is a damning and fatal flaw for an incentive program to have. **Uncertainty is the enemy of investment.**

The program is intended to encourage businesses to invest in R&D, not cause investment to be avoided, delayed or off-shored. Innovative businesses should not be blind-sided by debilitating debt which has to be repaid to the ATO, from which they cannot recover.

ASBFEO even found that some small business owners have experienced depression and stress from their dealings with AusIndustry and the ATO, and some have been put off ever applying again. (pp.26-27). It is a scathing finding by the ASBFEO that: "…many companies are scaling down their R&D efforts in Australia and have reduced R&D staff due to their experience with both agencies' compliance activities and the uncertainty surrounding eligibility and the substantiation of the R&D and its expenditure." (p.16)

Viewed through this lens, **removing uncertainty** from the R&D program is a hugely important aspect that the BoT review of the administration should address.

What is causing the uncertainty? While it is partly due to the themes in 1 and 2 – Role integration/efficiency issues and STI Technical skill deficiencies - it is for the most part due to the significant overarching issue of interpretation and application of the law. This likely is driven by culture and governance issues.

The overly narrow interpretation and application of the law works as a disincentive, rather than an incentive, as it creates huge uncertainty and risk, therefore eroding the attractiveness of claiming the incentive at all.

The ASBFEO confirmed that they "identified an overall 'shift' in the way the R&DTI legislation has been interpreted over the last three to four years; a narrowing of focus leading to a rejection of claims, which in previous years had been regarded as low risk. The way the program has been administered has created uncertainty amongst companies and their advisors and has undermined the policy intent of the R&DTI legislation." (p.4)

3.3 AusIndustry's interpretation and application of the law

Crucially, the case law reflects that **AusIndustry's approach to construing the legislation is not in accordance with its natural language, nor in accordance with its objects**.

This is a significant systemic administrative issue that needs to be rectified for the R&DTI to operate as intended and meet its legislative objectives.

The BoT should consider whether changes to the dual regulatory model might help achieve this objective.

3.3.1 Ordinary meaning - text and context

AusIndustry has been taking an unnecessarily narrow interpretation of "core R&D activities", which causes eligible activities to be viewed as isolated, insignificant fragmented activities (a 'mosaic effect', dicing up the project into small eligible and ineligible activities), instead of viewing it as a larger whole that is made up of a number of activities that are a connected series of "experimental activities", all of which are eligible core R&D activities that form an R&D project.

In *Moreton Resources Limited v Innovation and Science Australia* [2019] FCAFC 120, the Full Federal Court held at [151 - 152]:

> "… the Tribunal misconstrued the words "experimental activities" in the opening line of s 355-25(1) by treating these words as not covering activities having the purpose of generating new knowledge with respect to the application of an existing technology at a new site (at least in circumstances such as those of the present case). **The Tribunal's construction is not supported by the text, context or purpose of the provision**… **The text of the provision, whether one looks at the words "experimental activities" or the text of paragraph (b), does not impose any such limitation**.

AusIndustry (IISA) in *Moreton Resources* sought to draw non-existent distinctions between 'experiment' and 'observation'. They tried to characterise the activity of applying existing technology at a new site to acquire new knowledge, as merely "testing or observing the results of applying an existing technology at a particular site and nothing more", and therefore not experimental. They argued that Moreton Resources was not carrying out the project "to solve a problem, develop a new product or improve a process", at para [143(b)].

It seems that AusIndustry (IISA) also asserted that Moreton Resources was not carrying out the "project" as a whole for a purpose that met the definition. They submitted that "whether particular activities can legitimately be categorised as part of a broader "project level" activity is a question of fact. In some circumstances, it may be appropriate for the definition of "core R&D activities" to be applied to a number of aggregated registered activities which, on proper characterisation, are components of a single experimental activity", at para [143d]. Therefore, AusIndustry (IISA) appears to have taken the opportunity to view the activities at the "project level", but only in this case where it was to knock the whole project out.

CA ANZ understands that in recent years, AusIndustry (IISA) has moved away from viewing activities at the R&D project level.

In the recent case of *PKWK and Innovation and Science Australia* [2021] AATA 706 (March 2021), the correct approach to interpreting and applying "experimental activities" was also discussed by the Tribunal at para [292]:

> "It is appropriate when considering whether the activities undertaken in this application were experimental within the meaning of section 355-25(1) of the ITA Act to recall some of the observations made by the Full Court of the Federal Court in *Moreton Resources Ltd v Innovation and Science Australia*. The Full Court noted that the words "*experimental activities*" in the opening line of section 355-25(1) have very little, if any, work to do beyond reflecting the type of activities described in subparagraphs (a) and (b) of this subsection. The Full Court held that, given the detail and content of the description in subparagraphs (a) and (b), **it is difficult to envisage activities that would meet the description in paragraphs (a) and (b) but would not be considered experimental activities**. Experimental activities can apply to activities that have the purpose of generating new knowledge with respect to the application of an existing technology at a new site."

And in *PKWK* at para [33], the Tribunal rejected AusIndustry's approach that sought to make the 'outcome' of the experiment, rather than the progression of work, the focus as the activities that need to be experimental:

> "The process or progression of the work described, rather than the outcome or result, is the factor which the Tribunal must consider when applying section 355-25(1)(a) of the ITA Act. Such outcome or result however, is relevant by reason of the need to consider whether it could have been known in advance."

And at para [229] in *PKWK*, the Tribunal held:

> "The Applicant contends, and the Tribunal agrees, that the language of section 355-25(1) allows for a set of related experimental activities to be registered and evaluated against the statutory criteria. Therefore, a consideration of a single outcome arising from a set of related experimental activities is permitted."

The Tribunal therefore also validated a "project level" approach being taken to applying the law to and registering eligible core R&D activities, and related supporting R&D activities.

3.3.2 Purpose and objects

Chartered Accountants have told CA ANZ that AusIndustry is administering the law in a way that is failing to take into account the objects of the law in adopting their administrative interpretations.

The AAT has made some clear and cogent statements in recent cases, most recently in *PKWK*, observing at para [24] that:

> "The objects contained in section 3 of the IR & D Act should also be considered for the purposes of this application. …such objects include supporting and encouraging collaboration in the development and delivery of programs relating to industry, innovation, science and research. A further ***object*** is ***the promotion of the development and improvement of the efficiency and international competitiveness of Australian industry by encouraging R & D activities, innovation and science activities and venture capital activities***. It is perhaps useful to acknowledge that the language used in drafting this section places some emphasis on the considerations of Australian industry and venture capital activities. The Tribunal considers that ***the industry and commercial quotient of these objects must be borne in mind*** when considering the substance of this application. ***In construing the relevant legislation applicable to this application and applying it to the relevant facts, these industry-based objects direct the decision-maker towards industry and venture capital considerations***. These may differ from those that might be applicable to an institutional or academic environment, such as may be the case at the CSIRO or universities. ***Therefore, the task of construing this legislation must be undertaken with a degree of realism, adopting a beneficial and commercial approach, consistent with the text and objects referred to, for the purpose of encouraging research and development in a commercial setting."*** (emphasis added)

In *Moreton Resources Limited v Innovation and Science Australia* [2019] FCAFC 120, the Full Federal Court made it clear at para [153] that:

> "…the ***purpose of the research and development provisions does not support the Tribunal's construction***. The object of Div 355 of the ITAA 1997 is to encourage industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian economy (s 355-5(1), set out above). The ***object is to be achieved by providing a tax incentive for industry to conduct, in a scientific way, experimental activities for the purpose of generating new knowledge or information "in either a general or applied form*** (including new knowledge in the form of new or improved materials, products, devices, processes or services)".

These are all very important statements. They are aligned with what CA ANZ and our members have been advocating to AusIndustry for many years.

CA ANZ recently put forward these judicial pronouncements on the objects and the need for a purposive interpretation to the ATO and AusIndustry at the R&D Roundtable and requested that they incorporate them into the new guidance document that has been released. AusIndustry advised that they had incorporated *Morton Resources*, but that they had not yet decided whether *PKWK* decision would be appealed.

CA ANZ notes furthermore that AusIndustry's response to losing the *Moreton Resources* case itself seems to 'read down' or not fully appreciate the full implications of the Full Federal Court's interpretation of the meaning of "core R&D activities" and "supporting R&D activities". AusIndustry's response – acknowledging the decision, but holding the view that it may not apply on a case by case basis – suggests to the reader that the Full Court's interpretation was in line with their approach. However, it was not. The decision specifically rejected AusIndustry's approach and mindset in construing these key provisions of the R&DTI, as outlined above.

3.4 Consequences of interpretation

The consequences of these decisions are:

- Firstly, that AusIndustry's approach to interpreting and applying the law was held to be incorrect and must be changed to be compliant with the law.
- Secondly, as AusIndustry's approach is not a purposive interpretation, what will suffer longer-term is the outcomes that the Act is pursuing – innovation, efficiency and international competitiveness of Australian industry.

AusIndustry is perceived by CAs to be reading down the legislation in a narrow, contorted way that has led to R&D projects that are eligible being treated as ineligible, and whole R&D projects being artificially splintered by viewing the activities and applying the law in a strained manner.

AusIndustry needs to ensure that the scope of R&D is not circumscribed by an impermissible construction of the law that cuts out the heart of what R&D is really about. R&D and innovation in an industry or commercial setting is about understanding the value of technology or inventions to users' and society's needs and putting in place all of the broader business processes to support the creation of that value. Much of that activity will be core R&D and supporting R&D.

In this regard, CA ANZ notes the recent emergence of the notion of 'non-R&D innovation', and we are eager to ensure that eligible R&D is not increasingly being artificially split out and cast off into this territory in a way that erodes the R&DTI.

4. Accountability and Performance Standards

Accountability is an essential characteristic of good governance. An overwhelmingly consistent observation and concern of many members and R&D practitioners is that AusIndustry is not accountable for their decisions or performance.

Based on the comments above, CA ANZ considers that the root cause or enabler of the concerns raised in themes 1 to 3 may be that AusIndustry has limited accountability or no requirement to do a self-assessment of its own performance as an administrator, to obtain feedback from stakeholders, and to report to the Minister.

4.1 Regulator Performance Framework (RPF)

It seems that the national 'Regulator Performance Framework' (RPF) and its KPIs do not apply to AusIndustry (IISA). The reason for this is not known or apparent.

By contrast, the ATO and the Tax Practitioners Board (TPB) are both required to report under the national RPF under The Treasury portfolio, along with seven other Treasury agencies who report.
The RPF was introduced on 1 July 2015 to remove inefficient or ineffective regulation (red tape) and to reduce the cost on individual businesses and the community.

In the Department of Innovation, Science, Energy and Resources (DISER) portfolio, nine agencies report under the RPF, however AusIndustry (specifically IISA), is not one of them.

This apparent lack of accountability to report and self-assess against the national RPF may explain why AusIndustry (IISA) has in recent years displayed some real efficiency problems, such as:

- Not effectively performing its oversight role for 'activities' in a timely manner,
- Demonstrating poor STI technical skills and/or soft skills,
- Lacking engagement with claimants and stakeholders, and
- Interpreting and applying the law in a way that may not be permitted by law.

Since 2018, AusIndustry (IISA) appears to have a new Charter, however this applies to the whole DISER government department, and is not specific to AusIndustry's 'clients' who claim the R&DTI. The BoT should consider whether AusIndustry should have a dedicated Charter covering the exercise of its powers and functions and its interactions with claimants in administering the R&DTI.

If AusIndustry (IISA) reported under the RPF, it would be required to report against six outcomes-based KPIs:

1. Reducing regulatory burden
2. Communications
3. Risk-based proportionate approaches
4. Efficient and co-ordinated monitoring
5. Transparency
6. Continuous improvement

The RPF requires regulators to look at how they operate and the burden they create when administering regulation. They develop metrics and self-assess, then this assessment is externally discussed/evaluated in dialogue with stakeholders.

From 1 July 2021, a new RPF guide applies. It states that:

> "Accountability and transparency are core elements supporting regulator best practice".
>
> "The new reporting requirements are designed to increase accountability and transparency of regulator performance, by bringing regulator performance clearly within the scrutiny of Parliament through the tabling of Annual Reports as well as within the scope of the Auditor-General."
>
> Publicly available Ministerial Statements of Expectations and Statements of Intent also drive increased accountability, as regulators are required to report on their performance against Ministerial expectations.
>
> "Stewardship is about how we manage regulation through the lifecycle of development, implementation, review, reform and engagement. It involves embedding principles into our regulatory processes, such as the principles of best practice regulator performance."

In CA ANZ's view, the RFP appears to be a significant missing piece of the puzzle, which if put in place has the potential to help resolve the accountability problem, and as a result, could produce improvements in all of the areas of concern, given that they correlate well with the six KPIs.

Ultimately, AusIndustry (IISA) should be held accountable to delivering on the headline object of its own Act – "***to position Australia as a leading innovation nation***". Australia has the potential to achieve this objective in spades. However, Australia's success in achieving and positioning our nation for prosperity this decade will depend largely on how well AusIndustry (IISA) is enabled to perform its functions and execute new strategies to achieve the relevant goal in para (d) ***promoting the development, and improving the efficiency and international competitiveness, of Australian industry by encouraging R&D activities, innovation and science activities and venture capital activities***."

"**3 Object of Act**

The object of this Act is to position Australia as a leading innovation nation by:

(a) facilitating the provision of independent strategic advice about investment in industry, innovation, science and research; and

(b) supporting and encouraging collaboration in the development and delivery of programs relating to industry, innovation, science and research; and

(c) authorising spending on programs relating to industry, innovation, science and research; and

(d) promoting the development, and improving the efficiency and international competitiveness, of Australian industry by encouraging R&D activities, innovation and science activities and venture capital activities."

4.2 Reasons for decisions

On registration applications, AusIndustry (IISA) must decide whether to register or refuse to register activities as core R&D activities, or supporting R&D activities under section 27A of the IRD Act.

Under section 27B, AusIndustry (IISA) may make findings that all or some of the activities in the application are either core R&D activities, or supporting R&D activities, or neither.
One of the key functions that CA ANZ has identified is that AusIndustry (IISA) is not carrying out in any

satisfactory way is its **obligation to provide reasons for its decisions**.

Under subsection 27C(2)(c) AusIndustry (IISA) must give reasons for each finding that it makes.

Similarly, and as noted above in this submission, one of the obligations of administrative decision-makers under the rules of Equity is to make decisions that are "intelligible". This is the same thing – it is a requirement to give reasons.

In the R&D context, it is worthwhile the BoT reflecting that the R&DTI is an incentive that is intended to induce companies into private investment in R&D. When companies are induced into incurring that additional expenditure in reliance on the existence of the R&DTI, it is incumbent upon AusIndustry (IISA) to provide sufficient reasons for a finding that the legislative criteria that create an entitlement to the tax offset have not been met. Viewed from this perspective, again the circumstances suggest that AusIndustry (IISA) has an obligation akin to an equitable obligation to provide sufficient reasons.

Section 27C states:

"27C Notice of decision about registration

(1) The Board must notify an applicant in writing of the Board's decision under subsection 27A(1) about the application.

(2) The notice must include a certificate for each finding (if any) made under subsection 27B(1) for the application. The certificate must set out:

(a) a description of the finding; and

(b) the Board's reasons for the finding; and

(c) the activity affected by the finding; and

(d) the matters (if any) specified in regulations made for the purposes of this paragraph.

The notice and certificate may set out other matters.

Note: The notice could also mention the applicant's right to have the finding reviewed under Division 5 (see section 30B).

(3) The Board must give the Commissioner a copy of the notice if the notice includes one or more certificates.

(4) A failure to comply with this section does not affect the validity of the decision or finding."

(emphasis added)

Likewise, we note that section 27K, which applies to statutory examinations (internal reviews) of findings about registrations, also has a statutory requirement in ss(2)(b) to provide reasons for the findings or refusals to make findings.

From a review of the judgments in *Moreton Resources* [see para 114] and *PKWK*, [see para 19], there are scant to no reasons from AusIndustry (IISA) referred to or able to be discerned from the reasoning of the Tribunal members or judiciary.

Based on discussions with CA members and other R&D practitioners, it appears that AusIndustry (IISA)'s notices about decisions only provide ss(2)(a) and (c) content above, but do not meet the requirement in (2)(b).

CA ANZ understands that AusIndustry (IISA) says it does not have to give reasons for original decisions.

However, if a claimant asks for them when they have an internal review, they will give them the reasons in a report.

When the claimant receives the report, however, it does not contain reasons that are evidence-based, nor reasons that are set out in any detail. The main detail provided is simply the facts provided by the claimant in the claim. The 'reasons' received are only the decision that the activities were not eligible core or supporting R&D activities. There are insufficient reasons for a claimant to be able to refute and state why the activities are eligible R&D activities.

These comments by Associate Professor Leighton McDonald may be of assistance to the BoT in understanding CA ANZ views on what the standard should be for AusIndustry's statutory obligation to provide reasons for its findings:

> "It might be thought that a requirement to merely give the 'actual reasons' for a decision sets the standard of adequacy in a manner that is divorced from any analysis of the substance of the reasons. An obligation to give the actual reasons for a decision requires only that the decision-maker record the authentic reasons they had for the decision and to provide these to affected persons. It is a step related to the making of the decision, but does not impose any substantive adequacy constraints; that is, constraints that depend on the quality of the content of the reasons.
>
> Even in relation to the [b]are statutory obligation considered in *Wingfoot*, however, this conceptualisation of the adequacy requirements for a statement of reasons is misleadingly narrow. In framing the obligation in terms of the actual path of reasoning, the High Court also emphasised that that ***path of reasoning must be explained in sufficient detail to enable a court to consider whether any legal errors had been made***. To the extent that a statement of reasons must be an exercise in explanation, further 'adequacy constraints' must surely follow. Although any adequacy constraints must be derived from a particular statutory obligation***, a reason-giving requirement would cease to be a reason-giving requirement if it did not demand that a statement of reasons have some level of explanatory value***. This is recognised through the imposition, in other contexts, of requirements to state the 'essential ground' for a conclusion or to ***provide sufficient detail to enable a person to understand why a decision went against them.*** The general point to emphasise is that the idea of reasons (as an attempted justification or explanation) has an internal structure that will necessarily (or, at the very least, ordinarily) ***imply minimal requirements beyond the requirement that the reasons given be the actual or authentic reasons for the decision***."[14]

Also, to address the uncertainty - and any AusIndustry view that it does not need to provide reasons - CA ANZ suggests that s 27C and s 27K could be amended to describe the sufficient level of reasons required to comply with ss(2)(b).

In addition, consideration should be given to specifying that failure to comply with ss(2)(b) will have some other consequences that protect the claimant, such as preventing the ATO from acting on it to take recovery action until such time as the reasons are provided.

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[14] McDonald, Leighton, "Reasons, Reasonableness and Intelligible Justification in Judicial Review" [2015] SydLawRw 22; (2015) 37(4) Sydney Law Review 467

5. Interaction with Stakeholders

As the BoT may be aware, the national R&D Roundtable is the peak national consultation forum between stakeholders and the dual administrators of the R&DTI.

The R&D Roundtable is now conducted based on a rolling panel of members that meet two to three times per year (March, July and November as required).

CA ANZ is a member of the panel and whilst our professional body appreciates being invited to the R&D Roundtable, the stakeholder experience with the current Roundtable meetings is not as positive as it could be.

We believe that the R&D Roundtable format is not a very productive means for stakeholders to engage with the dual administrators for the following reasons:

1. There are now three distinct Panels - Tax Agents, Tax and Industry Associations and Companies - from whom the selection is made to receive an invite for the meetings. This creates an unworkably large group of approximately 40 people who have to be accommodated. Although perhaps not deliberately intended, the large group size enables the dual administrators to dilute engagement and accountability to the key stakeholders of the R&DTI. Previously, the members of the R&D National Reference Group (NRG) were from a smaller group of key stakeholders who were much closer to and are specialists in the R&DTI.

2. Only half of the panel members are invited to each R&D Roundtable meeting, i.e. 20 out of 40. Meetings are currently only held twice per year. Each panel member is invited to attend at least one meeting per year. This means that there may be over a year between meetings for a panel member. This may lead to the perception of a 'divide and conquer' approach to stakeholders, rather than bringing everyone together to build trust and confidence. As a result of the division and lack of continuity, there is a lack of transparency and a sense of exclusion and secrecy in terms of what is being said by the other part of the whole stakeholder group, because stakeholders are only half in the picture and half in the dark on the issues that are raised and discussed in those other sessions. CA ANZ notes that the previous NRG, which met four times per year, involved all of the stakeholders each being invited to every meeting.

3. Stakeholders who are not invited to the R&D Roundtable have not received notification of the R&D Roundtable meeting being held (with the exception of the latest meeting, after a panel member specifically requested a notification email be sent). Therefore, panel members are not kept in the loop that the Roundtable is being held on a particular date, nor is the Agenda shared with them.

4. The Webex video meetings that are held involve only being able to see the ATO and AusIndustry reps. For example, the R&D Roundtable meeting on 22 April 2021, for some reason did not allow stakeholders to see the videos or even the names of the stakeholders that were on the conference call. It did not show anyone else as attending the meeting, other than the ATO and AusIndustry co-hosts. This seems like an odd way to be engaging with external stakeholders, as it is an isolating experience and does not convey as respectful to the stakeholder group who are very collegiate amongst themselves. Stakeholders should have the courtesy of being able to see each other and know who is 'at the table' and 'in the room'. It is recognised that these issues may just be temporary as meetings cannot be held face to face due to COVID, and/or may be inadvertent due to technology settings/limitations.

5. Minutes of the R&D Roundtable meeting are not kept, only Meeting summaries which are posted to the Roundtable webpage where members need to go to find them.

CA ANZ recommends that the BoT evaluate the feedback from stakeholders on the R&D Roundtable and consider how AusIndustry could improve this consultation forum with stakeholders, noting that the R&D Roundtable's Terms of Reference state that the Purpose of the Roundtable is:

> "To provide an opportunity for dialogue between key stakeholders on priorities and emerging issues (administrative and technical) in the R&D Tax Incentive and increase effective collaboration between government and key stakeholders. The forum will:
>
> - Invite members to share information, ideas and insights about the program
> - Help members understand key issues in the program
> - Update members on developments and trends within the program
>
> This is not a forum for discussing policy issues, however, members are invited to raise and discuss challenges and solutions."

The BoT review provides an ideal opportunity to substantially overhaul the dual administrator's interaction with and treatment of R&D stakeholders to build a two-way relationship of trust, confidence and respect that is necessary for effective administration of the R&DTI.

Appendix B

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 130,000 financial professionals, supporting them to build value and make a difference to the businesses, organisations and communities in which they work and live.

Around the world, Chartered Accountants are known for their integrity, financial skills, adaptability and the rigour of their professional education and training.

CA ANZ promotes the Chartered Accountant (CA) designation and high ethical standards, delivers world-class services and life-long education to members and advocates for the public good. We protect the reputation of the designation by ensuring members continue to comply with a code of ethics, backed by a robust discipline process. We also monitor Chartered Accountants who offer services directly to the public.

Our flagship CA Program, the pathway to becoming a Chartered Accountant, combines rigorous education with practical experience. Ongoing professional development helps members shape business decisions and remain relevant in a changing world.

We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

Our support of the profession extends to affiliations with international accounting organisations.

We are a member of the International Federation of Accountants and are connected globally through Chartered Accountants Worldwide and the Global Accounting Alliance. Chartered Accountants Worldwide brings together members of 13 chartered accounting institutes to create a community of more than 1.8 million Chartered Accountants and students in more than 190 countries. CA ANZ is a founding member of the Global Accounting Alliance which is made up of 10 leading accounting bodies that together promote quality services, share information and collaborate on important international issues.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents more than 870,000 current and next generation accounting professionals across 179 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications.

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