

Record Keeping of R&D Expenditure and Activity

Basis for Presentation

This presentation has been based on an AusIndustry guidance publication titled “Compliance Readiness – The importance of record keeping and preparation of registrations and applications”

- <https://www.business.gov.au/Assistance/Research-and-Development-Tax-Incentive/Record-keeping>

Substantiation and Records

Substantiation of the nature and occurrence of R&D Activities has been a large focus for AusIndustry compliance reviews over recent years.

A company must have records available from different phases of a project's life, including:

- From before when experiments occur to explain why there is an unknown outcome and new knowledge to be generated from an experiment; and
- During the experiments to show the relevant observations and conclusions arising from the experiment.

Principles of good record keeping

The *R&D Tax Incentive* guidelines and requirements contain a series of principles relevant to maintaining compliance of R&D Record keeping.

The principles of compliance seek to add benefit by:

- Enhancing the likelihood of successful R&D outcomes through, promoting good practices;
- Manage tax risk and reduce time spent defending compliance reviews, in the event that they may occur;

Principles of good record keeping

Principle 1:

- Ensure that internal processes and systems allow for R&D Tax Incentive documentation requirements to be satisfied as part of the overall project planning and management process.

Principle 2 :

- Identify and document your R&D projects and eligible activities at the time they are conducted – this can improve the potential to capture associated costs in real time.

Principle 3:

- Document your methods for evaluating projects, identifying eligible R&D activities and recording expenditure associated with eligible activities – this ensures that there is a clear understanding of how information has been derived and enables the process to be repeated in future years.

Principle 4:

- Forge strong connections between those responsible for preparing and maintaining R&D Tax Incentive records and staff who understand the technical aspects of a project to enable a shared understanding of program requirements.

Principle 5:

- Ensure that strong links have been established between activity and expenditure records.

What sort of records should a company decide to keep?

- Each company should determine what documents they should keep, and each company will approach their documenting of R&D activities and expenditure differently;
- Whatever processes are adopted, records must be sufficient to show that the claimed R&D activities took place, and that they met the relevant aspects of the legislative definition for either ‘core R&D activities’ or ‘supporting R&D activities’;
- Companies will have their own systems and methods for evaluating projects and activities, and for preparing their applications for registration;
- Registrants will need to identify what information and figures they need to collate and how to obtain the data.

Nature of records required

- Records may come from a diverse range of sources such as:
 - Meeting notes;
 - Records of research and literature reviews
 - ERP systems;
 - Business plans and technical reports;
 - Testing reports and notes;
- Records maintained must allow the company to show the company's activities meet all aspects of the legislative definition for either core R&D activities or supporting R&D activities.
- Eligible R&D Activities are Core or Supporting, and differing records are required for each.

Records required for a Core Activity

For Core R&D activities records should document:

- The state of knowledge or technology that existed before the R&D Activity was undertaken;
- The new knowledge or information concerning the creation of new or improved materials, products, devices, processes or services that was sought through the R&D;
- That the knowledge or information was not publicly available. For example, this might include: literature reviews, patent searches or extracts from technical journals;
- Documents detailing the experiments undertaken and the experiments' results, such as test reports.

Records required for a Supporting Activity

For supporting R&D activities, records should document:

- That a 'directly related' relationship between the supporting R&D activity and core R&D activity existed and was sufficiently direct, close and immediate.
- If supporting R&D activities produce, or are directly related to producing goods or services, further records are needed to demonstrate how the company determined that the dominant purpose of these activities were to support core R&D activities.

Examples of records:

Examples of evidence that is likely to assist includes:

- Project planning documents
- Design of experiments
- Project records and laboratory notebooks
- Design documents for system architecture and source code
- Records of trial runs
- Progress reports and minutes of project meetings
- Test protocols, test results, analysis of test results and conclusions;
- Photographs and videos
- Samples, prototypes, scrap or other artefacts;
- Contracts
- Records of resources allocated to the project, eg. asset usage logs;
- Staff time sheets; and
- Tax invoices.

Questions AusIndustry could ask:

- AusIndustry may undertake an examination of registrations as part of their compliance processes;
- In the event of an examination, a company must respond to questions and provide documentation to support that activities in their registration occurred, and were in accordance with the legislation;
- In being compliance ready, a company should have kept and be able to produce records that support their response to questions around eligibility;
- The AusIndustry guidance lists the following questions which can often arise during an examination or review.

Questions AusIndustry could ask:

- *Was an experiment or set of related experiments carried out? If yes, has the company described that activity.*
- *What was the new knowledge that the company was seeking to generate?*
- *What existing technology was available and why did it not meet the company's needs?*
- *Could the proposed solution to the 'knowledge gap' be found using current knowledge, information and experience? If not, why not?*
- *Did the experimental work progress in a systematic way? If yes, how?*
- *If an eligible activity was identified, how long did it retain the characteristics of an eligible activity – when did it stop being an eligible activity?*
- *Were any of the activities specifically excluded (in the legislation) from being core R&D activities?*
- *Were there any non-experimental activities that were directly related and necessary to conducting the eligible experimental activities? Was the activity undertaken as a normal part of business operations and what was its link to eligible R&D activities?*
- *Was there a purpose to the activity other than to support the core R&D activity? If so, what was that purpose?*

Compliance Readiness Checklist:

The following are key steps for identifying eligible R&D activity:

1. Review and understand the R&D Tax Incentive's basic requirements, including the key legislative definitions of core and supporting activities.
2. Ensure that the proposed core R&D activity involves 'an experiment or a set of related experiments'. Note that activities with similar objectives, addressing the same or similar knowledge gaps can be grouped together as a distinct core R&D activity.
3. Prepare and retain a short statement that can be provided as a record of your company's self-assessment rationale (i.e. the steps that you took in order to establish the eligibility of your claim).
4. Document the method, including any judgements and underlying assumptions for extracting expenditure from accounting systems and assigning that expenditure to eligible R&D activities.

Compliance Readiness Checklist:

The following are key steps for Record keeping processes:

1. Prepare a template to use for evaluating projects and activities and for meeting with the project's key technical staff;
2. Record externally sourced information such as literature reviews, patent searches and scientific journals;
3. Capture and record specific technical project documentation, including conversations with relevant technical project staff or from external information sources.;
4. Keep expenditure records such as timesheets, general ledger entries and invoices to verify the amount of expenditure incurred on R&D activities. Further guidance on electronic record keeping can be found on the ATO's website at ato.gov.au.
5. Prepare a spreadsheet or template that allows for eligible R&D costs to be consolidated into a format which allows for direct input into the ATO Research and Development Tax Incentive Schedule.
6. Continue to make file notations and update records to track the progress of an R&D activity.

Compliance Readiness Checklist:

Additional steps to take for management of R&D Compliance Include:

- Seek to align R&D tax documentation requirements with processes for general business records , including accounting and project management systems;
- Larger businesses may consider developing a more detailed 'R&D Tax Incentive Manual' which lists all of the tasks and processes associated with the preparation of applications for registration and for maintaining appropriate records. This may be considered an appropriate measure due to the variety of business systems used to collate R&D tax information, the size and complexity of projects and the diverse groups of people involved in the process;
- Staff responsible for coding expenses to eligible R&D activities and deciding on eligible R&D expenditure need to understand the program's requirements and ideally have a good understanding of the R&D project and its activities. This will allow them to make suitable decisions around the allocation and recording of activity.

Case Study 1:

Registration of R&D Activities:

This case study from the AusIndustry Guidance illustrates the principles of a good registration and why it forms an important part of compliance readiness. The case study also shows how by providing clear and accurate information in their application for registration, DataCoAnalytics:

- minimises their compliance risks including the likelihood of being selected for a Pre-Registration Review, Desk Review or a Finding about a Registration Application; and
- is better prepared to provide the necessary information as part of a Registration Review or Post Registration.

Case Study 1: DataCo Analytics

DataCoAnalytics has received an extremely large data set courtesy of the Square Kilometre Array (SKA), and plans to use it to produce a primary school teaching package (“SkyWonder”) which will use the data to create 3D visual depictions of areas of outer space.

The company conducted a range of activities in order to research, develop, test and finalise its product. After searching the market place, DataCoAnalytics could not find any existing tools or solutions it could apply to query the SKA data set in the way needed for SkyWonder. This meant that the company needed to develop and then implement a new approach to solving its problem.

DataCoAnalytics embarked on a project to create a new algorithm that could search the SKA data set to locate elements necessary to display 3D images based on parameters a user has selected. DataCoAnalytics also proceeded to develop the graphical user interface (GUI) for SkyWonder using the Java and OpenGL programming languages.

To access the *R&D Tax Incentive* DataCoAnalytics prepared the following registration and categorised the various activities as either core or supporting. In the course of identification and claiming of R&D activities the company deemed that it would register one core R&D activity and one supporting R&D activity.

Case Study 1: DataCo Analytics

What records did DataCoAnalytics keep?

As part of their experimental work, DataCoAnalytics:

- *retained the results of test runs of the algorithm, including 'failed' tests that produced incorrect results, and documented the results of running these prototypes on test data from the SKA*
- *kept version repository logs with sufficiently detailed comments on the prototypes indicating the iterative development, testing and improvement of the algorithm including weaknesses that were identified and rectified in successive versions*
- *managed their R&D using a project plan, including a risk management plan, that set out the business aims and technical hypotheses, explained the design of the experiment to test the hypotheses, described the observations and analysis that resulted from each of the experimental processes they engaged in; and*
- *kept a register of all of the relevant technical scoping and business planning documents which could be used to substantiate their claim should they be subject to an AusIndustry compliance assurance review.*

Programme Administrator Contact

- <https://www.business.gov.au/assistance/research-and-development-tax-incentive>
- <https://www.ato.gov.au>

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