

R&D Tax – Identification and Assessment of Activities

Basis for Presentation

- This presentation has been based on the AusIndustry guidance publication: “R&D Tax Incentive: Guide to Interpretation”
- <https://www.business.gov.au/Assistance/Research-and-Development-Tax-Incentive/Guidance-and-information/Resources-library>

Principles of self assessment

Under the R&D Tax Incentive, companies must assess them self in respect of whether they are eligible to register R&D activities.

Self-assessment process

1. Is your company an 'R&D entity'?
2. **Have you undertaken eligible 'R&D activities'?**
3. Can you identify expenditure incurred or assets used in the activities?
4. Have you kept records which describe:
 - what you did,
 - the expenditure you claimed,
 - and the connection between the expenditure incurred, the assets used and the activities conducted?

Eligible R&D Activities

Presentation will focus on the internal process for assessment of R&D Activities.

- For the purposes of assessment under the R&D Tax Incentive, activities will be either:
 - eligible core R&D activities;
 - eligible supporting R&D activities; or
 - Ineligible activities not to be registered;
- In order to register eligible activities, you must have undertaken, or be intending to undertake, at least one core R&D activity.
- Certain activities are excluded from being core R&D activities. You may be able to register other supporting R&D activities if they meet certain requirements;
- When assessing if you may meet requirements for a given year, consider:
 - Have you undertaken, or intend to undertake, at least one core R&D activity?
 - Have you checked that the activity is not excluded from being a core R&D activity?
 - Have you undertaken supporting R&D activities?

Core R&D Activities

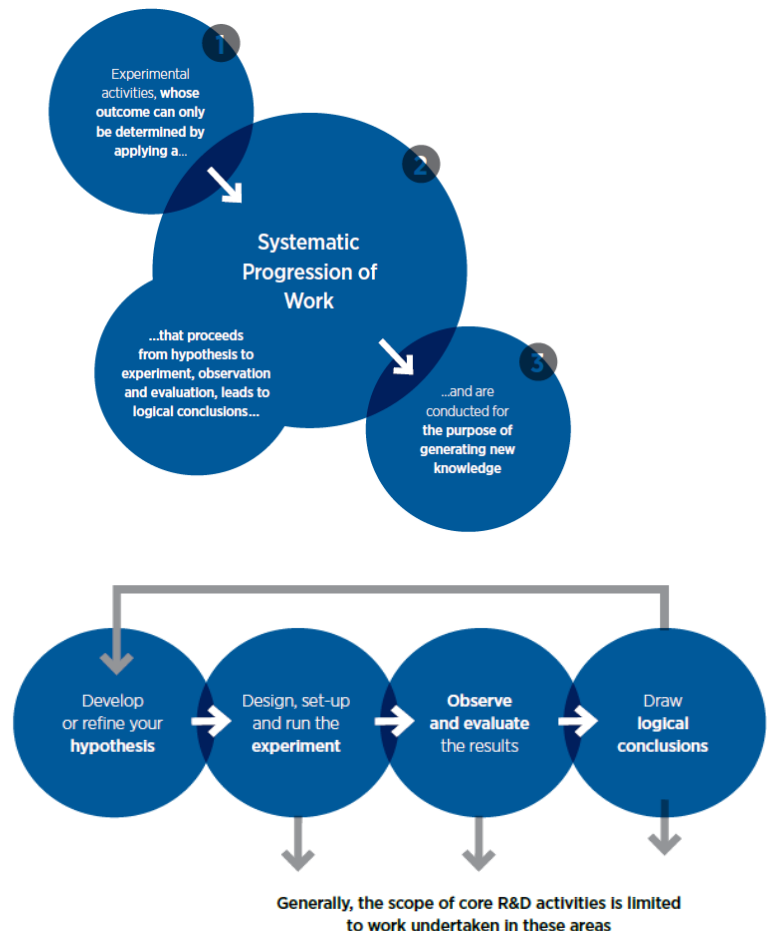
Definition of Core R&D Activities is specified in the income tax legislation.

Core R&D activities are experimental activities:

- a. whose **outcome cannot be known** or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a **systematic progression of work** that:
 - i. is based on principles of established science; and
 - ii. proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and
 - b. that are conducted for the **purpose of generating new knowledge** (including new knowledge in the form of new or improved materials, products, devices, processes or services).
- Each of the requirements of the legislative definition must be met to qualify;
 - If a particular part of your work is not a core R&D activity, it may still qualify as a supporting R&D activity and be eligible under the programme.

Core R&D Activities

This figure provides an illustration of how each of the three key requirements of the overall core R&D activity test work together:



Hypothesis – Core Activity

A hypothesis is simply a statement that can be proven right or wrong by conducting an experiment.

- Validity of hypothesis will be a key focus during compliance processes;
- Hypothesis is the idea being investigated during experiments, and will direct the design and conduct of the experiment, observation and evaluation;
- Hypothesis must reflect a particular technical or scientific idea and is commonly expressed as a relationship between variables (or technical features) which can be proven or disproven;
- It is important that the hypothesis relates to a specific experiment or set of related experiments, and not the project as a whole;
- Must focus on the technical or scientific area of uncertainty, and not be framed in terms of any commercial or economic aims.

Examples of Hypotheses

Example of appropriate hypotheses that can be tested in experiments to investigate relationships between variables and prove as true or false:

- *Applying the Company's newly-developed data-processing algorithms to astronomical data sets of more than 1 terabyte in size will yield results appropriate for generating 3D visual depictions of areas of outer space in real time.*
- *Combining a new polyurethane with metal flakes that have been coated with magnesium fluoride to a general water-based paint will produce a glossy, stable, two-coat, metallic paint without the need for a coat of clear lacquer;*

Example of an insufficient hypothesis where there is no way to disprove hypothesis and it is unclear what is being specifically tested:

- *Whether particular computer software can be developed to include the latest research from the planning community.*

Experiment, Observation, Conclusions

Identifying experiment important in the assessment and application preparation process:

- The experiment is what you do to test the hypothesis.
- The experiment is set up so that the relationship between relevant variables can be tested and the hypothesis proven right or wrong.
- A series of experiments may be grouped as one core R&D activity so long as they are all aimed at testing the same hypothesis or related hypotheses.

Observation and evaluation refers to the observing, measuring and recording of information and results:

- An assessment of the experiment and its outcomes, and whether it worked as expected and was thereby able to test the hypothesis.
- Allows you to analyse, consider and evaluate what the outcomes of the experiment actually mean.

Logical conclusions bring together the results of your evaluation to make decisions or findings.

- Forming of a considered view on whether the experiment showed the hypothesis to be right or wrong.
- If your hypothesis was not consistent with your conclusion, do you have to do something differently and try again?
- Or, if it was successful, do you now have the knowledge you need to inform the development of the next stage of your new product, service or process?

Outcome cannot be known or determined

- Key requirement for a Core Activity is that the outcome of the hypothesis being tested (the technical or scientific idea), must not be able to be determined in advance.
- Focus upon the technical or scientific ideas and what is being done to investigate those ideas. In other words, those parts which investigate the ‘causal relationships among relevant variables’.
- Whether an outcome can be known or determined in advance without applying a relevant systematic progression of work is judged by:
 - on the basis of knowledge, information or experience that is publicly available or reasonably accessible, anywhere in the world;
 - whether a competent professional in the field knows or can determine the outcome (i.e. whether the hypothesis is true or false), without conducting an experiment as part of a systematic progression of work.

What does a competent professional look like?

Competent professional in an R&D Tax Assessment is a person who:

- is knowledgeable and experienced in the relevant field and technology;
- possesses the relevant qualifications (if appropriate) and experience necessary to participate in the relevant field with a reasonable level of skill;
- keeps up to date with developments in the relevant area, and
- has access to knowledge around the world, including access to publically and generally accessible resources, for example the internet, relevant industry journals and other professionals in the area.

How will I know if the knowledge, information or experience is available?

AusIndustry need to understand steps taken to see whether knowledge being sought was available prior to conduct of experiments, and whether any existing solutions were identified.

It's expected that claimants can show:

- research into the available information in the scientific, technical or professional literature in the relevant area; and
- seeking advice from an expert(s) in the field. This could be someone in your company, or industry sector, a consultant or an academic expert in the field.

Guidance acknowledges that if you need to design and conduct an experiment to progress your work, then it is more likely that the outcome **cannot** be known or determined in advance on the basis of current knowledge, information or experience.

Knowledge and information that is commercially sensitive, held closely by a competitor, and is not available to the general public, is not considered to be 'reasonably accessible'.

The purpose of generating new knowledge

- Core Activities must be conducted for the purpose of generating new knowledge;
- Guidance concedes that there can be multiple purposes for conducting an experiment and knowledge generation does not have to be the only purpose;
- Generation of new knowledge must however be a **significant purpose**. In other words, the generation of new knowledge must be important to the company and a driving force for undertaking the activity;
- Substantiating the purpose of an experiment can be done by records, including plans, minutes, and internal memos. AusIndustry are likely to give greater weight to documentation dated from the outset of the activity to justify the relevant purposes;
- Knowledge generation must be a purpose at the time activities are undertaken, AusIndustry guidance states it is not enough to undertake activities for another purpose, only later to discover that the activities were useful because they also happened to generate new knowledge.

Generating new knowledge

- The experiment must seek to generate knowledge that is new to the world.
- New knowledge for these purposes is that which is not already available in the public arena at the time the activities were conducted. For the purposes of the programme it is knowledge that can only be generated by undertaking an experiment as part of a systematic progression of work. If you are able to access the knowledge without needing to undertake a systematic progression of work, then it will not be new knowledge.
- If the knowledge of whether something is scientifically or technically possible, or how to achieve it in practice, is deducible by a competent professional in the relevant field, then it will not be new knowledge.

Excluded Core R&D Activities

There are certain activities which cannot be Core R&D activities. These activities are referred to as excluded activities:

1. **Market research:** Activities conducted to discover consumers' or potential consumers' interest in products or services;
2. **Prospecting, exploring or drilling:** Concerned with activities searching for a resource and drilling for samples for analysis of the deposit;
3. **Management studies or efficiency surveys:** investigation into the efficient or effective conduct of the business, or a part of the business and an investigation into potential cost savings;
4. **Research into social sciences, arts or humanities:** Activities in respect of Economics, Anthropology, Sociology, Psychology, Politics, Literature, History, Philosophy, Fine Art, Theatre, Music and Dance;
5. **Patenting, licensing or other activities:** researching, preparing and filing applications for intellectual property registrations;
6. **Complying with statutory requirements or standards:** activities that are undertaken by a company to meet a legislative requirement or an industry or other standard;
7. **Reproduction of a commercial product or process:** This exclusion is concerned with activities that seek to recreate an existing product or process;
8. **Software development for use in internal administration:** Development of software for the dominant purpose of use in the day-to-day administration of a business or its functions such as payroll or accounting functions.

Supporting R&D Activities

- Activities not experimental themselves, but required for the experiment to occur, can be potentially registered. Supporting R&D activities are activities **directly related** to core R&D activities.
- Dominant purpose test applies where activities supporting activities are related to the production of goods or services.

Examples of how supporting R&D activities can be directly related to core R&D activities

- *A literature search on durability testing which informed the design of the experiment to effectively test the hypothesis;*
- *The supporting R&D activity produced a test rig used in the experiment;*
- *The supporting R&D activity manufactured a small batch of new design syringes which were used in the experiment.*

Supporting R&D – Directly Related to Core Activity

- Each supporting activity must be directly related to one or more core R&D activities. In other words, the activity must have a direct, close and relatively immediate relationship with one or more components of the relevant systematic progression of work.
- Supporting R&D activities may be conducted **before, during or after a core R&D activity** is conducted. The key is that they must be directly related to the conduct of a core R&D activity.

Examples from guidance:

- **Before:** *A literature review to inform the design of the core R&D activity or the production of a prototype for experimentation.*
- **During:** *The cleaning, maintenance and monitoring of aquaculture tanks that are used to keep fish stock for the development of a new feed pellet.*
- **After:** *The deconstruction of equipment and the disposal of waste items used in the experiment.*

Programme Administrator Contact

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