

# **Substantiation of R&D Expenditure and Compliance with ATO Guidance**

# Basis for Presentation

- This presentation has been based on an ATO guidance publication titled “Keeping records and calculating your notional deductions”
- <https://www.ato.gov.au/Business/Research-and-development-tax-incentive/In-detail/Guides/Keeping-records-and-calculating-your-notional-deductions>

# Current ATO Compliance focus on substantiation of R&D Expenditure

- Substantiation of the incurrence of R&D Expenditure and nexus with registered R&D Activities has been a large focus for ATO compliance activity over recent years;
- Additional funding for compliance reviews of R&D Tax Submissions was announced in the May 2018 federal budget;
- Companies should take steps to thoroughly review the R&D Expenditure positions and ensure they have suitable documentation BEFORE submission of claims;

# General Principles – R&D

## Record Keeping

- When lodging an R&D Claim, additional records are required in addition to the general reports maintained for general business tax purposes;
- When lodging an R&D Claim, a company must keep records that show:
  - how R&D expenditure incurred relates to the R&D activities registered with AusIndustry, as described in the application;
  - how you may have apportioned your expenditure between eligible R&D activities and ineligible activities;
  - that the R&D activities were on the R&D entity's behalf, and not for another entity;
  - incurrence and payment of expenditure, particularly if the expenditure was incurred by an associate entity;
  - how you have calculated adjustments that may arise if the R&D entity receives a grant (clawback) or produces a marketable product (feedstock adjustments) from R&D expenditure.

# Nexus of R&D Expenditure with R&D Activities

- R&D expenditure is eligible only to the extent it is incurred on R&D activities. Companies must show how R&D expenditure reported in their tax return has been incurred on the specific activities registered with AusIndustry. During review, ATO would seek records to show how each item of expenditure relates to the specific R&D Activities Registered;
- Administrative costs and overheads may be incurred on R&D activities if there is a direct link between the R&D activities and the expenditure incurred.
- Ineligible expenses are those without sufficient link to the R&D activities, particularly if they relate to general company operations or marketing expenditure that would be incurred regardless of the R&D activities.

# Records for R&D Salaries

- ATO has increased their expectations around documentation of R&D Salaries in recent years. Companies must substantiate the time spent on eligible R&D projects by employees (personnel who carry out the R&D project);
- The most accurate and effective method of allocating time is to maintain timesheets or job cards, and the ATO's position is that if you don't use these methods, it may be more difficult to show that the allocation of time is accurate;
- In the ATO's guidance they do however acknowledge that it may not always be practical to retain timesheets or job cards. If so, a summary sheet may be acceptable;
- The recent Ozone Manufacturing AAT case found that a company must have records that show:
  - The time spent on R&D activities on specific dates;
  - The work performed daily and how it relates to the R&D activities;

# Records for contract expenditure

- Where R&D Activity is undertaken by an external contractor, records must be available for R&D Contract expenditure which show:
  - The date(s) the R&D activities are undertaken;
  - Sufficient detail to ascertain the amount of expenditure incurred on the R&D activities, as opposed to other goods or services being provided under the contract. This may include:
    - The contract;
    - Invoices;
    - Evidence of work carried out such as project reports or schedules;
  - Contractual terms which support that ownership of results belong to the R&D entity (not the invoicing contractor), and that the R&D entity beared the financial risk of development;

# Records for direct R&D expenditure

- Other direct R&D Expenditure (including materials/feedstock) must be supported by records which show:
  - The specific registered R&D Activity that the R&D Expenditure item relates to;
  - Evidence of incurrence such as tax invoices;
  - Records around market or sale value of R&D Inputs where a feedstock adjustment may be required;



# Apportionment of Expenditure – SWANSON REED

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## General Principles

- For some types of expenditure incurred on R&D activities, it may be difficult to examine each invoice to calculate the amount of expenditure applicable to the R&D activity. ATO Acknowledge that a company may need to apportion the expenses in this case;
- The basis of apportionment for R&D Expenditure has been scrutinised in recent years;
- The ATO requires that companies review and ensure that the appropriate basis of apportionment is determined for each expenditure type based on all of the following:
  - the type of R&D activities being conducted;
  - how the company is conducting the R&D activities;
  - the type of expenditure incurred which is being considered for apportionment.;

# Apportionment – Principles in withdrawn IT2552 not accepted

- IT2552 in effect under the old R&D Tax Concession has been withdrawn, and the ATO specifically do not accept the guidance in this ruling to be relevant to the current R&D Tax Incentive;
- The previous IT2552 ruling:
  - Allowed for a single basis of apportionment for eligible expenditure based on *((eligible R & D salaries and wages) / (total company salaries and wages))*
  - Provided a list of expenditure classifications that would generally be accepted as connected to eligible R&D projects, such as: cleaning, electricity, insurance, postage, printing, rent and telephone costs;
- ATO specifically do not accept a uniform basis of apportionment for R&D Expenditure and the old IT2552 principles must no longer be used;

# Apportionment – ATO guidance under the R&D Incentive

- Specific guidance on apportionment methods under the R&D Tax Incentive include:
  - *For expenditure incurred over a period of use (such as electricity, decline in value of R&D assets), an apportionment based on the time spent by employees on R&D activities over total company employee hours may be more appropriate than a dollar value of R&D salary;*
  - *For expenses such as rates, land taxes, rent and lease costs which are mainly for the area used for R&D activities, an apportionment based on the area of use may be appropriate;*
  - *The apportionment basis of R&D salaries over total company salaries will only be considered reasonable where the expenditure is based on how much an employee earns (for example, payments of super, worker's compensation and payroll taxes);*

# Programme Administrator Contact

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

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