R&DTI – REVIEW OF THE DUAL-AGENCY ADMINISTRATION MODEL

KPMG Submission

KPMG Australia

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Content

Executive Summary

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. We strive to contribute to the debate that is shaping the Australian economy and welcome the opportunity to provide a response to the *Board of Taxation's review of the dual-agency administration model for the Research and Development Tax Incentive (R&DTI)* (the Review).

Growth in productivity is key, particularly in the economic recovery from the COVID-19 pandemic, since it generates more sustainable growth, stronger global competitiveness and better living standards.

KPMG welcomes the Board of Taxation's (the Board) focus on evaluating the R&DTI dual-agency administration model, given the importance of this incentive to Australian productivity. The Review seeks to identify opportunities to reduce duplication, simplify administrative processes and reduce compliance costs between the administrators: the Australian Taxation Office (ATO), Industry Innovation and Science Australia (IISA) and the Department of Industry, Science, Energy and Resources (DISER). AusIndustry sits within DISER and delivers the program on behalf of IISA and is referred to by industry as the R&DTI's second administrator.

Growth in productivity is key, particularly in the economic recovery from the COVID-19 pandemic, since it generates more sustainable growth, stronger global competitiveness and better living standards. Industry investment is a strong enabler of productivity growth with research showing R&D investment increases the technological potential of an economy[1]. A stable R&DTI is one of the most effective means for the government to achieve increased business productivity and economic growth, and an effective administration model is critical to the success of the R&DTI. It is also important to remember that there is a risk of change fatigue amongst claimants, so any significant changes to the program must be well founded and produce real benefit.

Whether there is a single or dual agency model going forward, the legal framework, administrative practices, use of experts and interpretation of the legislation all need to align and we believe there are opportunities to streamline the process and address some challenges that exist in the current model.

KPMG's submission seeks to directly respond to the consultation questions and sets out 27 recommendations at section one. KPMG's recommendations include providing clarification on the roles and responsibilities of the administrators, the publication of AusIndustry metrics or key performance indicators, the development of a R&DTI Customer Charter, archiving superseded guidance to ensure previous guidance is publicly available and the allocation of a single case manager or liaison person who can help coordinate administrator reviews and other interactions.

[1] Bayarcelik, Ebru & Taşel, Fulya. (2012), Research and Development: Source of Economic Growth. Procedia - Social and Behavioral Sciences. 58. 744–753.

It is important that any clarification on the roles and responsibilities of the administrators starts with a review of the legislative framework to ensure the administrative model is well founded. From there, clear and unambiguous guidance around the roles, responsibilities and accountability of the administrators will be essential for taxpayers looking to claim their R&D activities.

In addition, a number of options have been proposed to lower compliance costs for taxpayers, including the potential application of standard methodologies which would be subject to 'safe harbour' arrangements and further guidance material in relation to eligible expenditure and how the ATO expects it to be evidenced.

KPMG looks forward to continued engagement with the Review as the Board progresses its final report and recommendations.

Yours sincerely,

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Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

Accelerating Business Growth team

KPMG's Accelerating Business Growth (ABG) team is dedicated to developing integrated advice aimed at supporting the growth ambitions of our clients. We work with our clients to understand their business needs and assist in delivering holistic advice that enables them to reach their growth potential.

Our R&D team within ABG assists some of Australia's most innovative companies gain access to government grants and incentives for R&D activities undertaken in Australia. We also assist companies in developing governance frameworks, policies and procedures to streamline their R&D processes and substantiate their R&D activities, and look to provide opportunities for further government support through our local and global network and our connections with federal and state government agencies and industry bodies. Through these initiatives, we work with our clients to create long term value and assist in providing a competitive advantage for Australian companies.

Section 1: KPMG recommendations

Current administration model (Question 1)

1) Clarification on the respective roles, responsibilities and accountabilities of the two administrators needs to be re-established, starting with a review of the legislative framework to ensure the administrative model is well founded. From there, clear and unambiguous guidance around the roles, responsibilities and accountability of the administrators will be desirable for taxpayers looking to access the R&DTI.
2) The legislation should be amended to provide clear deadlines and timeframes in which administrators can make and act upon findings.
3) Taxpayers should be advised when and what communications will and have occurred between administrators, and any joint reviews or resolutions between AusIndustry and the ATO should be clearly set out for taxpayers.

Dealings with the current administration model (Questions 2-7)

4) The well-known process of lodgement of an R&D application document has recently changed to using the new AusIndustry Portal. Early experience suggests the portal would benefit from further refinement in consultation with industry.
5) The Australian Small Business and Family Enterprise Ombudsman outlined several recommendations for the administration and compliance approach for the R&DTI program in its December 2019 report. To the extent that these have not been implemented, these should be considered in detail as part of the Board's review process.
6) The administrators should seek to rely on direct evidence from the technical team who undertook the R&D activities and/or relevant supporting records which are reflective of R&D undertaken in a commercial setting.
7) Performance could be strengthened by the publication of AusIndustry metrics or key performance indicators (e.g. average time taken to issue registrations, commence and conclude reviews, issue findings, etc.). Care would need to be taken so as not to truncate the process and timeframes at the expense of taxpayers or proper administration of the program.
8) Greater co-ordination between the administrators would increase efficiency and lower compliance costs for businesses which have been duplicating internal processes to meet requirements. Options that could be considered to further lower compliance cost include:
   - The potential application of standard methodologies which would be subject to 'safe harbour' arrangements;
   - Guidance in relation to eligible expenditure and how the ATO expects it to be evidenced; and
   - Appointing a single 'liaison officer' and ensuring reviews are commenced and concluded in a timely fashion after a claim is made.

9) A R&DTI Customer Charter be developed in consultation with industry to provide taxpayers with confidence that administrators will administer the program in a fair, transparent and accountable manner.

10) Administrators should not retrospectively apply new approaches and guidance when assessing earlier registrations and claims, where the new guidance products are materially different to prior published guidance on which taxpayers would have based their submitted claims and documentary approach and this could form part of the R&DTI Customer Charter.

11) Superseded guidance and approaches should be archived and kept publicly available as a point in time reference available to both administrators and taxpayers.

12) Allocation of a single case manager or liaison person who can help coordinate administrator reviews and other interactions.

13) Greater training and use of specialist R&DTI assessors with a background or some level of accreditation in both tax law and the taxpayer's industry.

14) That administrators be obliged to properly consider all forms of taxpayer evidence and provide taxpayers with detailed reasons for adverse decisions.

15) Risk ratings in SARs and similar ATO reviews should not be disproportionately impacted by areas beyond the ATO's review (and that have not been fully assessed) or where the adjusted R&D expenditure is immaterial to the overall claim.

16) The Review investigate administration arrangements in other jurisdictions that may have lower cost of compliance and consider what, if any, administrative improvements can be replicated here.

17) Consider ways to provide more certainty to claimants accessing the refundable R&D offset. This could include limiting the review period to one or two years after the end of the income year.

18) The Advance and Overseas Findings process has been complicated for businesses to navigate although, we welcome the recent reduction in application timeframes and encourages further progress to this regard.

19) The ATO should publish guidance on its application of the incidental or insignificant expenditure on overseas activities rule and ensure superseded guidance is archived and kept publicly available.

20) The introduction of a risk-based approach that would see certain lower risk applications effectively fast tracked could be considered so long as this is not at the expense of time frames for other applicants.

Improvements and efficiencies (Questions 8-10)

21) It may be beneficial to reconsider the need to register all R&D activities or whether taxpayer registration with sample coverage, like the UK model, would reduce compliance without adversely impacting program integrity.

22) The introduction of a publicly available R&DTI Customer Charter could help ensure administrators are transparent and accountable for their administration of the program.

23) To reduce duplication between the administrators, there needs to be clear and consistent practice and process guidelines for reviews, examinations and audits that are conducted by each agency separately, concurrently, or jointly.

24) Guidance material should seek to set out for taxpayers clear reasoning behind the specific interpretation of the legislative provisions and these should be clearly referenced in all guidance materials going forward. In addition, it should be very clear if guidance is to be applied retrospectively, or only prospectively, and the tracking of guidance that is updated or changed can be improved.

25) To further incentivise innovative software development, the Government could consider a specialised Software Development Tax Incentive (SDTI) to provide support for innovative software

solutions which do not qualify for existing tax incentives or grants. Options for the SDTI were outlined in KPMG's recent report Principles for an innovative software development tax incentive[2] .

26) While historic R&D guidance outlined approaches to calculate a proportion of certain overhead costs, in recent years, the ATO's guidance webpages have reduced or deleted sections of this guidance. Accordingly, there is some uncertainty on actions that companies should take to appropriately recognise these costs and further guidance would be welcome.

International models and experience
(Question 11)

27) KPMG considers that the Board should consult widely with administrators of other R&D tax incentives in like jurisdictions but importantly also consult with taxpayers in those jurisdictions who have direct experience and can provide insights as to the strengths and weaknesses of how those programs are administered

[2] Innovative software development tax incentive - KPMG Australia (home.kpmg)

Section 2: KPMG Insights, Consultation questions

Current administration model

Question 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?

At the time the current R&DTI was introduced in 2011, it was reasonably clear that Industry Innovation and Science Australia (at the time called Innovation Australia), through AusIndustry[3] would be largely responsible for administering the program under the Industry Research and Development Act 1986 (IR&D Act). The Commissioner of the Australian Taxation Office ("the ATO") would be responsible for the operative provisions under the then new Division 355 of the Income Tax Assessment Act 1997 (ITAA 1997)[4] .

This distinction was reflected in all available guidance and re-iterated in the 2016 Administrative Appeals Tribunal decision in JLSP[5] where the Tribunal took the view that Division 355 was split between definitional provisions (the domain of AusIndustry) and operational provisions (the domain of the ATO). Whilst the Tribunal's decision was in relation to the role of AusIndustry, it aligned with the policy intent of the R&DTI and industry understanding of the distinction between the roles and responsibilities of the two administrators.

Since then, this distinction has become less clear with the ATO often reviewing the nature and scope of registered R&D activities. This has led to taxpayer confusion and in some cases, duplication in review activity by both administrators (which is especially burdensome when the outcomes of those reviews are at odds with each other). While R&DTI advisers usually have a better understanding of the intended roles and responsibilities, taxpayers (especially SMEs) often observe that the roles are not clearly understood, largely as a result of the duplication described above.

This has led to a perception by industry that the respective administrators themselves have not always evidenced a mutual understanding of the extent of their roles and jurisdiction. For example, if one administrator is not empowered to assess certain aspects of an R&D claim, claimants do not understand why that administrator would comment on its "concerns" about that aspect (see confidential Appendix A for anonymised taxpayer examples).

Most recently the in-obiter comments of Thawley J of the Federal Court in Auctus[6] must also be recognised. Thawley J

[3] The R&DTI is administrated by the Australian Taxation Office (ATO), Industry Innovation and Science Australia (IISA) and the Department of Industry, Science, Energy and Resources (DISER). AusIndustry sits within DISER and delivers the program on behalf of IISA and is referred to by industry as the R&DTI's second administrator.
[4] See paragraphs 1.3, 1.4, 1.40 and 1.41 of the Explanatory Memoranda to the Tax Laws Amendment (Research and Development) Bill 2010.
[5] JLSP is an Australian-based company carrying out contracted research services for an unrelated foreign company. Under the contract, JLSP was to receive full payment regardless of the outcomes of the contracted activities it undertook. All data and new knowledge generated under the contract were not owned by JLSP, nor did it have any rights to that data or knowledge.
[6] Commissioner of Taxation v Auctus Resources Pty Ltd [2021] FCAFC 39

(supported by McKerracher J and Davies J) made observations in passing (obiter dictum) (at paragraph 32 of Auctus) that the ATO may provide its own view on the eligibility of a taxpayer's R&D activities, as a function of the Commissioner's general powers to administer the tax laws. While the relevant comments made by Thawley J are not central to the decision (and are therefore persuasive and not binding), they are significant and may create further uncertainty on the distinction between the roles and responsibilities of the two administrators.

The legislative structure does not always assist in clarifying roles. The definitional provisions sit within ITAA 1997, which falls within the ATO's remit. If the definitional provisions were in the IR&D Act, they would more clearly sit with AusIndustry. Thus, it is important that any clarification on the roles and responsibilities should start with a review of the legislative framework to ensure the administrative model is well-founded. From there, clear and unambiguous guidance around the roles, responsibilities and accountability of the administrators will be desirable for taxpayers looking to claim under the R&DTI.

The legislation contains further ambiguities for both administrators:

– It is generally understood that AusIndustry may only make a finding within four years from the end of the relevant income year; as indicated by paragraph 3.210 of the Explanatory Memoranda to the Tax Laws Amendment (Research and Development) Bill 2010. However, the legislation does not impose a statutory time limit for AusIndustry to make a finding, it is therefore currently possible that AusIndustry can make a finding that the ATO is unable to give effect to.

– The ATO can give effect to an AusIndustry finding if the finding is made within four years after the end of the relevant income year. If the AusIndustry finding is made within four years after the end of the relevant income year, the ATO has two further years to give effect to the finding if it increases the taxpayer's liability (there is no time limit if the liability is reduced).[7] However, there is ambiguity in the legislation as the ATO has given effect to AusIndustry findings made more than four years after the end of the relevant income year.

Taxpayers need to know a definitive time period when a finding can be made by AusIndustry and when it can be given effect to by the ATO. This will not only assist taxpayers, but also administrators of the program. The current lack of certainty as to when a given administrator position or taxpayer claim is beyond challenge runs counter to administrative law principles and causes unnecessary concern and uncertainty for everyone involved. Thus, KPMG considers the legislation would benefit from clarification and simplification so clear deadlines and time limits are set and acted upon.

Finally, taxpayers should be advised when and what communications will and have occurred between the administrators; largely to ensure transparency and accountability, but also to avoid confusion and duplication. Further, where a joint ATO and AusIndustry resolution occurs, this should be clearly set out for taxpayers.

Recommendations:

1) Clarification on the respective roles, responsibilities and accountabilities of the two administrators needs to be re-established, starting with a review of the legislative framework to ensure the administrative model is well founded. From there, clear and unambiguous guidance around the roles, responsibilities and accountability of the administrators will be desirable for taxpayers looking to access the R&DTI.
2) The legislation should be amended to provide clear deadlines and timeframes in which administrators can make and act upon findings.
3) Taxpayers should be advised when and what communications will and have occurred between administrators, and any joint reviews or resolutions between AusIndustry and the ATO should be clearly set out for taxpayers.

[7] See section 355-705 and 355-710 of the ITAA 1997

Dealings with the current administration model

Question 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?

There are several aspects to this question, and we note other questions refer to specific aspects such as overseas findings (Question 7) and R&D guidance updates (Question 10). Further to the responses to those questions, we provide commentary in relation to the following:

- Annual R&D registration and the new AusIndustry R&DTI Customer Portal (the AusIndustry Portal)
- Reviews of R&D eligibility

Annual R&D registration and the new AusIndustry Portal

The annual registration of R&D activities has been a longstanding requirement for companies to access R&D tax benefits, and with some minor exceptions, this element of the program has worked well.

This process has recently changed from the well-known process of lodgement of an R&D registration application document (describing the R&D activities undertaken by the taxpayer), to the submission of the R&D registration application information through a new online AusIndustry Portal. The new process requires identification of a relevant company officer (and their adviser as appropriate) as the relevant R&D authority for the company, through MyGov ID processes, and changes to the questions and information required to be submitted for each project and the underlying core and supporting R&D activities for which registration is sought.

Whilst it is pleasing to see the new format for describing R&D activities more closely aligns with the legislation, it appears many of the process changes may not be aimed at improving the annual registration process for taxpayers so much as increasing data collection and simplifying compliance review activities. From our limited observations so far, the new Portal is unlikely to reduce the administrative burden on taxpayers.

We also note that the new lodgement process includes the generation of warnings or risk areas that may be relevant to the taxpayer. Whilst the flagging of administrator guidance and ATO taxpayer alerts is appropriate, some of the warnings appear to be solely triggered based on taxpayer industry classifications (i.e. software or mining) rather than linked to consideration of the specific R&D activities included in the application. Review and potential refinement of Portal triggers and resultant wording may better ensure taxpayers (and their advisors) carefully consider all applicable guidance before lodging an application.

Reviews of R&D eligibility

Historically, AusIndustry R&D eligibility reviews were focussed on understanding the nature of the R&D activities, and whether the conduct of those activities could be substantiated through documentation (for example through technical drawings or trial reports). Over time, AusIndustry reviews became increasingly focussed on the strength of contemporaneous supporting documentation, rather than direct evidence from the technical team who undertook the R&D activities or relevant documentation which fell outside the review period.

On the policy front, when the R&D program was revised to the R&DTI program in 2010, some legislated documentation requirements (i.e. "R&D Plans") were removed, and the new program was outlined as "substantially simpler and accompanied by improved administrative arrangements" per the Explanatory Memorandum to the Bill.

On the legislation side, there is no requirement that R&D activities must be evidenced through contemporaneous documentation. Indeed, as

noted in the Federal Court case of Bogiatto,[8] Thawley J noted evidence may take many forms and the absence of "adequate or contemporaneous records to substantiate the claimed R&D expenditure" does not preclude R&D claims from being reasonably arguable by law.

These and other concerns were considered by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) in its 2019 review of administration of the R&DTI. The ensuing report released in December 2019 outlined several recommendations to improve the administration and compliance approach for the R&DTI program.

Since the ASBFEO review, several (but not all) of these recommendations have been acted upon. Combined with other changes in 2020, this has seen an improvement in administrator reviews, especially in terms of assessor responsiveness and parity in timeframes. It is also recognised that both administrators have worked hard to support industry throughout the COVID-19 pandemic and that the R&DTI has provided a valuable support for taxpayers looking to innovate during this difficult time.

Recommendations:

4) The well-known process of lodgement of an R&D application document has recently changed to using the new AusIndustry Portal. Early experience suggests the portal would benefit from further refinement in consultation with industry.

5) The Australian Small Business and Family Enterprise Ombudsman outlined several recommendations for the administration and compliance approach for the R&DTI program in its December 2019 report. To the extent that these have not been implemented, these should be considered in detail as part of the Board's review process.

6) The administrators should seek to rely on direct evidence from technical team who undertook the R&D activities and/or relevant supporting records which are reflective of R&D undertaken in a commercial setting.

Question 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.

As outlined in our response to Question 2 above, there have been improvements in the way the program has been administered since late 2019.

AusIndustry and the ATO have outlined their consideration of the recommendations and any appropriate actions of the ASBFEO 2019 report, as noted during the review by the Senate Standing Committee on Economics review of the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 in June 2020, and Questions on Notice responses thereafter.

A detailed letter[9] was provided to the ASBFEO that outlined several activities that were underway as at February 2020 in order to address the recommendations including:

- Establishing cross agency working groups to improve integration;
- Exploration of ways business keeps records to develop clearer guidance;
- Implementation of the RDTI Integrity Framework that focuses on pre-registration education advice and assessments wherever possible;
- A commitment that the DISER Service Commitment be underpinned with principles and practices and guidance be provided to staff;
- Commitment to a nationwide systematic training program for RDTI staff;
- Commitment from the ATO to undertake concurrent action with DISER to save companies money and time; and

[8] Commissioner of Taxation v Bogiatto [2020] FCA 1139
[9] Answer to question on notice no. 07, Department of Industry, Science, Energy and Resources, Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 [Provisions] 29 June 2020

– Exploration of a principle that would involve DISER taking a proportionate response in relation to the requirement of supporting evidence.

From our observations, the AusIndustry compliance approach has improved since 2019, and compliance reviews have been more focussed on understanding the nature of the R&D activities rather than focused on contemporaneous documentation alone. Whilst this is an improvement, formal clarification and confirmation would assist taxpayers.

Another welcome development has been the reduction in compliance review timeframes and a focus on more recent R&D activities rather than those that may have completed some years ago. However, it is important that any reduction in timeframes does not disadvantage taxpayers (see confidential Appendix A for anonymised taxpayer examples).

In this respect, performance could be strengthened by the regular publication of metrics or key performance indicators, noting this would need to be carefully considered so as not to truncate the process and timeframes at the expense of claimants. There may be an opportunity to enact such measures in the annual performance statement process[10]

This improvement in review timeframes has not been replicated across all areas of the program's administration. Of particular concern is the short consultation timeframes afforded by AusIndustry. An example of this was the current review of the Decision-Making Principles (DMPs) and Regulations due to sunset in April 2022. AusIndustry announced its review on its website on Friday 27 August 2021, inviting submissions by Thursday 9 September 2021. Further, the website announcement noted that there were several proposed changes, but we were not able to find these published anywhere. Such short timeframes and in this case, the failure to make proposed changes publicly available, is not conducive to meaningful consultation with industry. Given the DMPs are the closest instrument industry has to a "R&DTI Customer Charter", open consultation by AusIndustry is important.

Recommendations:

7) Performance could be strengthened by the publication of AusIndustry metrics or key performance indicators (e.g. average time taken to issue registrations, commence and conclude reviews, issue findings, etc.). Care would need to be taken so as not to truncate the process and timeframes at the expense of taxpayers or proper administration of the program.

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

As noted previously, greater coordination between administrators would increase efficiency and lower compliance costs.

In recent years compliance costs have increased due to taxpayers duplicating internal processes or even developing bespoke programs to meet administrator expectations in relation to documentation (especially where the administrator expects and requires documentation to contain specific language reflective of the R&D criteria, but contrary to how the taxpayer and industry might document their R&D activities). Reducing compliance costs for taxpayers must be balanced against ensuring the integrity and long-term viability of the R&DTI. There are a few options that could be considered.

For instance, the ATO has raised concerns that some taxpayers are claiming expenditure that is ineligible or does not reasonably reflect the cost of the R&D activity to which it relates. One option to address this may be to allow taxpayers to apply standard methodologies across different expenditure types which, if applied properly, would be subject to a 'safe harbour' arrangement and could thus provide taxpayers with greater certainty. This would still allow taxpayers to apply a different methodology should there be a reasonable basis for doing so and free up valuable ATO resources for more targeted reviews.

[10] Annual performance statements for Commonwealth entities (RMG 134) | Department of Finance

In addition, the program would benefit from further guidance in relation to eligible expenditure (e.g. contractor expenditure that meets the for whom and other eligibility criteria). Recent R&DTI-related draft Tax Determinations and Tax Rulings would benefit from refinement and are yet to be finalised.

Lastly, multiple case managers and contacts can increase compliance costs (and extend time frames). One option might be to introduce a single point of contact across both administrators. This contact could act as a 'liaison officer' across the two administrators and improve efficiency and customer service.

Compliance costs can escalate significantly when substantiating a claim due to uncertainty around the review process. This often involves significant costs through operational and research employee time to defend claims. In many cases, taxpayers will opt to accept an adverse position by an administrator, not because they agree, but because the time and cost involved quickly erodes any possible benefit from the program. Even where a review confirms the taxpayer's claim, the experience is such that those involved may be reluctant to claim again.

Recommendations:

8) Greater co-ordination between the administrators would increase efficiency and lower compliance costs for businesses which have been duplicating internal processes to meet requirements. Options that could be considered to further lower compliance cost include:

– The potential application of standard methodologies which would be subject to 'safe harbour' arrangements;

– Guidance in relation to eligible expenditure and how the ATO expects it to be evidenced; and

– Appointing a single 'liaison officer' and ensuring reviews are commenced and concluded in a timely fashion after a claim is made.

Question 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?

In this response we provide a summary of examples drawing on a range of experiences with clients and other taxpayers that have recently navigated the R&DTI application process.

In general, taxpayers report finding the R&D registration application process with AusIndustry to be overly complex and time consuming. By comparison, once registered, claiming R&D expenditure with the ATO is viewed as more straightforward. In this sense, the dual agency model creates challenges for taxpayers when reviews are conducted by both administrators and without the taxpayer being informed of communications between the two administrators. Taxpayer cost and resources required to manage one review, let alone two being undertaken by separate administrators in relation to the same activities is significant and, especially for smaller taxpayers, impacts their ability to conduct their day- to-day business. This is compounded when:

– There are concurrent reviews by both agencies where the same or similar questions are asked by both and the apparent level of administrator R&DTI and industry knowledge varies;

– The reviews relate to R&D activities undertaken many years ago and often where the technical team involved at the time are no longer with the taxpayer;

– Guidance has been retrospectively applied (e.g. after the new guidance issued in November 2016, AusIndustry asked taxpayers how they had applied the new guidance in reviews of their pre November 2016 R&D claims) and unrealistic time frames are given for the provision of responses (see confidential Appendix A for anonymised taxpayer examples).

One option that may help alleviate these problems would be having a single case manager or liaison person that taxpayers can discuss their concerns with and who can help coordinate administrator reviews and other interactions. Ideally such a person would have a background or some level of accreditation in both tax law and the taxpayer's industry.

Other recommendations to address these issues include greater guidance and examples on the level of evidence expected by both administrators and ensuring more recent guidance is not applied retrospectively (and that old guidance is archived but kept publicly available as a point in time reference – as is already the case with ATO guidance).

The creation of a R&DTI Customer Charter would help improve transparency and accountability. This, combined with clarification and simplification of administrator deadlines and time frames as recommended in our response to Question 1, would reduce the post of compliance, provide greater taxpayer certainty and generally increase efficiency with the program's current administration.

We also believe program administration could be improved through greater transparency and two-way dialogue in relation to reviews and assessment decisions (whether formal findings, preliminary conclusions or recommendations). Taxpayers report that they are sometimes not provided with specific reasons for a given position or decision and, in many cases, the entirety of the R&D claim is disallowed with little or no explanation or differentiation. Instead the administrator issues a high-level and pro-forma response which can lead to the perception that the administrator has not considered information provided by the taxpayer.

Where administrators use specialist teams with deep R&DTI and industry experience and knowledge, we would expect that taxpayers' perceptions of the quality of the administrative process to increase.

Concern was raised by many taxpayers that risk ratings ATO Streamlined Assurance Reviews (SARs) were often adversely impacted by the R&DTI component of the review based on:

a. the ATO stating that it was concerned that the R&D activities were not eligible while also stating that it was not its role to make this assessment (and without having asked for information on the R&D activities); and

b. small errors or taxpayer inclusion of non-material amounts from categories of expenditure which the ATO did not agree with.

In summary, the dual administrator model creates serious challenges and costs for applicants when reviews and examinations are conducted simultaneously by the two administrators - especially when unrealistic time frames are given for the provision of responses. Further problems can arise when the ATO review or audit is well advanced of the AusIndustry examination, which causes uncertainty as to how either review will impact the outcome of the other.

Recommendations:

9) A R&DTI Customer Charter be developed in consultation with industry to provide taxpayers with confidence that administrators will administer the program in a fair, transparent and accountable manner.

10) Administrators should not retrospectively apply new approaches and guidance when assessing earlier registrations and claims, where the new guidance products are materially different to prior published guidance on which taxpayers would have based their submitted claims and documentary approach and this could form part of the R&DTI Customer Charter.

11) Superseded guidance and approaches should be archived and kept publicly available as a point in time reference available to both administrators and taxpayers.

12) Allocation of a single case manager or liaison person who can help coordinate administrator reviews and other interactions.

13) Greater training and use of specialist R&DTI assessors with a background or some level of accreditation in both tax law and the taxpayer's industry.

14) That administrators be obliged to properly consider all forms of taxpayer evidence

and provide taxpayers with detailed reasons for adverse decisions.

15) Risk ratings in SARs and similar ATO reviews should not be disproportionately impacted by areas beyond the ATO's review (and that have not been fully assessed) or where the adjusted R&D expenditure is immaterial to the overall claim.

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

The current administrative process can impact the decision by taxpayers to apply for the R&DTI. We are aware of several taxpayers and employees who have been discouraged from accessing the program. In most cases, this is largely the result of having part (or all) of a claim disallowed. However, importantly there are also some cases where the R&D claim has been successful, but the taxpayers have chosen to no longer access the program as a result of the significant resources and costs expended in defending the claim.

Many taxpayers who have had their claims disallowed, particularly where it was for multiple years, ceased making claims. These range from ASX 100 to small private businesses, and even start-ups. For start-ups, the R&D offset can become an unaffordable liability should it be later disallowed. Investors and potential acquirers may discount the value of the R&DTI in their forecasts, and this can reduce access to capital.

R&D can be mobile and whilst there are many factors that dictate location like IP protection, government incentives, labour costs and access to industry expertise, high compliance costs quickly erode the tax benefit. As a result, we have observed some taxpayers opt to conduct their R&D activities in other jurisdictions; even those with a lower R&D incentive as the lower compliance costs mean the overall benefit is higher.

Recommendation:

16) The Review investigate administration arrangements in other jurisdictions that may have lower cost of compliance and consider what, if any, administrative improvements can be replicated here.

17) Consider ways to provide more certainty to claimants accessing the refundable R&D offset. This could include limiting the review period to one or two years after the end of the income year.

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

Historically the Advance Findings process has been complicated and protracted; typically taking at least six months and in some cases, up to 18 months. This timeline can and has impacted company tax reporting, with taxpayers lodging tax returns without the R&D claim (or the overseas component), and later having to amend their tax return if part, or all, of the overseas R&D was approved under the resultant finding.

The fact such findings cover multiple years and are binding on both agencies appears to have made AusIndustry reluctant to make such findings. Initial feedback from AusIndustry during the application process is often focused on reclassifying activities and can take multiple iterations of questions and responses before a positive outcome is achieved (see confidential Appendix A for anonymised taxpayer examples). We are also aware that some taxpayers have found the process too onerous and have withdrawn their application and, in some cases, withdrawn from the program and reconsidered where to undertake their R&D activities. However, it is also recognised that over the last six months, whilst the formal application process remains the same, the time taken by AusIndustry to review an application and make a finding has greatly reduced.

One potential improvement would be to introduce a risk-based approach that would see low risk applications effectively fast tracked. Lower-risk taxpayers could benefit from faster approval process although this should only be done in consultation with industry and it should not result in the application timeframes unduly increasing for taxpayers considered to be higher-risk.

Whilst an overseas finding is required in order to claim expenditure on overseas R&D activities, until recently guidance indicated incidental or insignificant expenditure on overseas activities could be claimed without such a finding (under the 'de minimis' rule). This guidance appears to have been removed from AusIndustry and ATO websites. If this represents a change in approach, it should be openly communicated to taxpayers and an archived copy of the guidance kept publicly available as a point in time reference (see our commentary under Question 5 and Question 10 on amendments to guidance)

Recommendation:

18) The Advance and Overseas Findings process has been complicated for businesses to navigate although, we welcome the recent reduction in application timeframes and encourages further progress to this regard.

19) The ATO should publish guidance on its application of the incidental or insignificant expenditure on overseas activities rule and ensure superseded guidance is archived and kept publicly available.

20) The introduction of a risk-based approach that would see certain lower risk applications effectively fast tracked could be considered so long as this is not at the expense of time frames for other applicants.

Improvements and efficiencies

Question 8: What changes could be made to simplify the administrative and compliance obligations for taxpayers, whilst maintaining the integrity of the program?

In addition to the recommendations made in previous parts of this submission, it may be beneficial to re-consider the need to register all R&D activities every year. For example, in the UK, HM Revenue & Customs (HMRC) takes a different approach where they can accept a sample coverage to describe activities, rather than registering every single activity, which reduces the compliance burden. In this respect, the current legislation can accommodate R&D claims where the taxpayer is registered for the R&DTI, but the individual R&D activities are not.

As noted previously, the government could consider a risk-based approach including considering whether smaller claimants could be classified into different risk categories than larger claimants. We note that in the UK large taxpayers have a dedicated HMRC tax manager assigned to them who is familiar with their business and can assist in facilitating R&D tax claims and reviews. Similarly, having a single point of contact or case manager for R&DTI matters may help simplify and streamline the administrative and compliance process for taxpayers without detracting from the program's integrity.

Ideally the program could be improved through reducing the number of contact points and duplication; how this is best achieved is the subject of this review. Options include imposing an obligation (if requested by the taxpayer) for administrators to hold joint meetings, clear deadlines and timeframe, published performance statistics and an enforceable R&DTI Customer Charter should all be considered.

Recommendations:

21) It may be beneficial to reconsider the need to register all R&D activities or whether taxpayer registration with sample coverage, like the UK model, would reduce compliance without adversely impacting program integrity.

22) The introduction of a publicly available R&DTI Customer Charter could help ensure administrators are transparent and accountable for their administration of the program.

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

Where a dual administration model continues, legislation, guidance material and practice of the agencies should reflect clearly delineated responsibilities, particularly when considering eligibility, as has been discussed in previous questions. Providing clear guidance material in line with the legislation and policy intent of the program and updated as new case law comes into existence could also help streamline administration.

Based on the existing model, there needs to be clear and consistent practice and process guidelines for reviews, examinations and audits that are conducted by each agency separately, concurrently, or jointly. This should address instances where either administrator requests the other to commence a review (which can lead to significant taxpayer uncertainty regarding time frames for completing any review/examination), and any joint approach to resolution on any areas of dispute with the taxpayer/R&D entity or between the agencies.

Recommendations:

23) To reduce duplication between the administrators, there needs to be clear and consistent practice and process guidelines for reviews, examinations and audits that are conducted by each agency separately, concurrently, or jointly.

Question 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)?

Given the complexity of the R&DTI, taxpayer guidance is key to ensuring taxpayers can self-assess eligible R&D activities and expenditure.

Since its inception in 2010, AusIndustry has periodically updated its guide to Interpretation and its specific industry guidance. Generally, these periodic updates have been minor and consistent in nature (i.e. agri-food, manufacturing, biotechnology, energy and built environment). However, some guidance (e.g. software-based R&D guidance) has seen significant revisions which have led to a degree of industry confusion, particularly where the reasons for the changes between revisions are not made clear.

Further, administrator guidance has often focused on what is not eligible rather than providing real world examples of what is considered eligible.

Availability and use of guidance

We note that in recent years, as more guidance is accessed through ATO or AusIndustry website pages (rather than legally binding instruments such as taxation rulings), changes have been made to website guidance without disclosure, and prior guidance becomes unavailable. The ad hoc revision to guidance increases the difficulty in navigating the program and does not appropriately recognise the basis for any changes and any differing administrator interpretations that companies should consider in preparing claims. For example, the ATO website updated its guidance webpages in July 2021, and it is not clear what changes were made, and if there has been a change in interpretation or approach that companies should recognise.

During AusIndustry compliance review processes, our observations indicate that guidance materials and published examples of eligible R&D activities are sometimes not given weight by the administrator, which dilutes the materials' value if companies cannot rely upon the guidance to provide comfort that eligible activities have been appropriately recognised. In addition, guidance cannot be relied on and cannot be used in disputes or AAT and court procedures, which further dilutes its value. To improve the value of published guidance, administrators could make more use of the option of issuing binding rulings. To this point, the new AusIndustry powers to make bindings rulings should assist going forward.

Finally, all guidance and rulings should include clear reasoning behind their specific interpretation of the provisions which increase credibility and transparency. Further and ideally in accordance with a R&DTI Customer Charter, it should be clear if guidance is to be applied retrospectively or only apply to claims from the date of issue (or some other future date).

AusIndustry guidance:

AusIndustry's software R&D guidance has undergone numerous revisions in recent years and when compared, these revisions reveal a shifting pattern of interpretation although the underlying legislative definition of core and supporting R&D activities has not changed at all.

While not in scope of the Review, to further incentivise innovative software development that positions Australia as a technology and financial centre, the Government could consider a specialised Software Development Tax Incentive (SDTI) to provide support for innovative software solutions which do not qualify for existing tax incentives or grants. Options for the SDTI were outlined in KPMG's recent report Principles for an innovative software development tax incentive.

ATO guidance

We note that as with AusIndustry guidance, the ATO has issued guidance which uses phrases such as 'business as usual' (BAU) or 'in the course of ordinary business' to indicate

activities or expenditure that isn't eligible. However, such terms are not supported by the legislation and thus cause a certain amount of industry confusion; especially where the taxpayer may be exclusively focused on R&D and thus, where not otherwise ineligible, its BAU or ordinary activities are eligible R&D activities.

Further confusion currently exists around the eligibility of apportioned costs such as rent and utilities where a portion of those costs is incurred in undertaking the R&D activities. While historic R&D guidance outlined approaches to calculate a proportion of certain overhead costs, in recent years, the ATO's guidance webpages have reduced or deleted sections of this guidance. Accordingly, there is some uncertainty on appropriate actions that companies should take to appropriately recognise these costs incurred by the business in conducting R&D activities (see also our recommendation under Question 4 in relation to use of safe harbours for using ATO approved calculations methods)

Finally, some of the ATO's more recent draft rulings have used examples which are not reflective of commercial dealings. For instance, in draft Tax Ruling 2021/D3 (TR2021/D3), the ATO's conclusions in Examples 6 and 9 do not align with what would be a logical conclusion based on the commercial circumstances which form the basis for these examples. It would therefore have been appropriate to include more explanation of how the ATO came to its conclusions, together with explanation of why the more logical conclusion would have been incorrect.

Recommendations:

24) Guidance material should seek to set out for taxpayers clear reasoning behind the specific interpretation of the legislative provisions and these should be clearly referenced in all guidance materials going forward. In addition, it should be very clear if guidance is to be applied retrospectively, or only prospectively, and the tracking of guidance that is updated or changed can be improved.

25) To further incentivise innovative software development, the Government could consider a specialised Software Development Tax Incentive to provide support for innovative software solutions which do not qualify for existing tax incentives or grants. Options for the SDTI were outlined in KPMG's recent report Principles for an innovative software development tax incentive[11] .

26) While historic R&D guidance outlined approaches to calculate a proportion of certain overhead costs, in recent years, the ATO's guidance webpages have reduced or deleted sections of this guidance. Accordingly, there is some uncertainty on actions that companies should take to appropriately recognise these costs and further guidance would be welcome.

[11] Innovative software development tax incentive - KPMG Australia (home.kpmg)

International models and experience

Question 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?

Based on our international experience, KPMG sets out an overview of our 'on the ground' experience with similar programs in the United States (US), United Kingdom (UK), New Zealand (NZ) and Singapore. In addition to the jurisdictions referenced below, the Canadian and German R&D tax incentive programs may also provide insights as they also rely on secondary agencies to assist with assessing the eligibility of R&D activities.

R&DTI US

In the United States the Internal Revenue Service (IRS) administers the Federal Research Credit program, but it is KPMG's experience that an assessment with regard to the eligibility of activities, may involve the use of IRS engineers, or even outsourced to third party experts, particularly with regard to more contentious issues such as software development. Where the taxpayer and the IRS disagree on an assessment, it is not uncommon for the parties to negotiate a settled position.

However, unlike Australia, a taxpayer's income tax position can impact its ability to utilise the Federal Research Credit and some individual state offer their own R&D tax incentives on top of the Federal Research Credit. This makes the US system in many ways more complex to navigate than the Australian R&DTI.

R&DTI UK

In the UK, the single agency model is administered by HMRC. IT-related R&D assessments are often referred through to HMRC's in-house IT team called the Chief Digital Information Officer (CDIO), however there are some concerns from industry that their knowledge of current industry developments could be improved. Larger taxpayers have assigned HMRC case managers across all tax matters, who are able to take a more tailored approach.

Another consideration of the UK model is that taxpayers do not have to register their R&D activities, instead a risk-based approach based on the value of the claim and an assessment of sample activities is used instead. While this can reduce compliance costs, this needs to be carefully balanced to ensure program integrity is not compromised.

R&DTI NZ

New Zealand, like Australia, uses a dual agency model, administered by the Inland Revenue Department (IRD) and Callaghan Innovation, New Zealand's innovation agency. The program commenced in 2019 and we understand there have been some initial difficulties for taxpayers in relation to the administration of the IT R&D aspect of the program which resulted in a review. The Government should consider whether there are any learnings from the NZ review that could be relevant to the current Review.

R&DTI Singapore

Singapore uses a single agency model administered by the Inland Revenue Authority of Singapore (IRAS). KPMG's experience is that there seems to be more audit activity in Singapore compared to Australia and these processes can continue for over a year which is often longer than any Australian equivalent. Audit teams may include both traditional IRAS backgrounds and technical specialists, so a dual approach is met in one agency.

Ultimately all R&D tax incentive programs encounter issues with their administration and as a global firm, our experience is that all have strengths and weaknesses. We therefore recommend the Board consult widely and seek to take the best elements of other programs if they may assist the Australian R&DTI to be better administered.

Recommendation:

27) KPMG considers that the Board should consult widely with administrators of other R&D tax incentives in like jurisdictions but importantly also consult with taxpayers in those jurisdictions who have direct experience and can provide insights as to the strengths and weaknesses of how those programs are administered.

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